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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

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No. 313

LONE STAR GAS COMPANY,

Appellant,

vs.

STATE OF TEXAS ET AL.

APPEAL FROM THE COURT OF CIVIL APPEALS, THIRD SUPREME JUDICIAL DISTRICT, STATE OF TEXAS.

STATEMENT AS TO JURISDICTION.

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CHARLES L. BLACK,
Counsel for Appellant.

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APPEAL FROM THE COURT OF CIVIL APPEALS, THIRD SUPREME JUDICIAL DISTRICT, STATE OF TEXAS.

STATEMENT AS TO JURISDICTION ON APPEAL.

Lone Star Gas Company, the above named appellant, submits this statement in accordance with Rule 12 of the Rules of this Court, as amended March 2, 1936, particularly disclosing the basis upon which it is contended that the Supreme Court of the United States has jurisdiction to review this cause on appeal from the final judgment entered herein by the Court of Civil Appeals for the Third Supreme Judicial District of Texas sustaining a rate order of the Railroad Commission of Texas, challenged as being repugnant to the Commerce Clause and to the Due Process Clause of

the Fourteenth Article of Amendment to the Constitution of the United States, as hereinafter more fully pointed out.[1]

I.

Statutory Provisions Sustaining Jurisdiction.

1. This Court has jurisdiction of this appeal under Section 237 of the Judicial Code, as amended (U. S. C. A., Title 28, Sec. 344a), which provides that,

> "(a) A final judgment or decree in any suit in the highest court of a State in which a decision in the suit could be had, * * * where is drawn in question the validity of a statute of any State, on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, and the decision is in favor of its validity, may be reviewed by the Supreme Court upon a writ of error. * * *"

2. Pursuant to the Act of January 31, 1928 (45 Stat. 54; U. S. C. A., Title 28, Sec. 861a), as amended by the Act of April 26, 1928 (45 Stat. 466; U. S. C. A., Title 28, Sec. 861b), the present appeal is brought in lieu of a writ of error.

II.

Statute of the State the Validity of Which is Involved.

The statute of Texas, the validity of which is herein involved, consists of an order of the Railroad Commission of Texas, of a legislative nature,[2] prescribing the maximum rates to be charged and collected by appellant, operating an integrated system of trunk pipe lines in both Oklahoma and

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[1] The Opinion of the State Court (copied as Appendix "A" hereto) expressly shows that these Federal questions were raised and were duly considered and decided by the Court.

[2] See *King Mfg. Co.* v. *Augusta*, 277 U. S. 100; *Sultan Ry. Co.* v. *Department of Labor*, 277 U. S. 135. The Texas courts hold that rate orders of the Commission "have the force and effect of statutes." *M. K. & T. R. Co.* v. *Commission*, 3 S. W. (2d) 489, 494.

Texas, for gas sold and delivered by it at wholesale at city gates to distributing companies in approximately 270 cities and towns in the State of Texas. This rate order is as follows:

> "The Railroad Commission having instituted a proceeding upon its own motion inquiring into the rates charged by the Lone Star Gas Company for domestic gas sold to distributing companies at the city gate station, hereby finds as a fact that the rate of $0.40 per thousand cubic feet, as now charged by Lone Star Gas Company is unfair, unjust and unreasonable.
>
> "Basing its order on the foregoing finding of fact and on such other findings and statement of facts as are set out in the opinion next preceding this order, or in this order
>
> "It is Ordered, Adjudged and Decreed that effective as of the next billing date the Lone Star Gas Company shall charge, bill and receive for domestic gas at the city gate from all distributing companies served by it, a rate not to exceed $0.32 per thousand cubic feet.
>
> "It is Further Ordered, Adjudged and Decreed that a rate not to exceed $0.32 per thousand cubic feet at the city gate is hereby fixed, approved and promulgated and found and declared to be fair, just and reasonable and shall remain in force and effect until the Commission shall have otherwise determined, pursuant to other proceedings in respect to the fixing of city gate rates for domestic gas on said Lone Star Gas Company's lines.
>
> "It is Further Ordered, Adjudged and Decreed that this proceeding shall be kept open for such further orders as may be proper.
>
> "The foregoing opinion and order are hereby approved and ordered filed as the opinion and order of the Railroad Commission of Texas.
>
> "Dated at Austin, Texas, this 13th day of September, A. D. 1933."

An applicable State statute subjects gas pipe lines to the "jurisdiction, control and regulation" of the Railroad

Commission (Art. 6050, Revised Civil Statutes of Texas, 1925). The Commission is authorized to fix reasonable prices and rates "for producing, transporting, selling and delivering gas by such pipe lines." (Art. 6053, Revised Civil Statutes of Texas, 1925.)[3]

The opinion of the Railroad Commission containing its findings of fact, and expressly made a part of the above order, appears in the record. Pertinent portions of the Commission's findings are summarized as follows:

(a) The Commission found that appellant is engaged "in the production, transportation and sale at wholesale of natural gas. It operates an integrated pipe line system of approximately 4,000 miles and is engaged in both interstate and intrastate commerce in the selling of gas to some 300 cities and towns within the States of Oklahoma and Texas. The Company's Texas properties and its Oklahoma properties constitute parts of an integrated operating system."

The Commission directed the reduced rate to be applied to all sales and deliveries to distributing companies at city gates in Texas, drawing no distinction between interstate and intrastate commerce.

(b) The Commission valued appellant's "integrated pipe line system", located in both States, as a whole, arriving at a value or rate base of $46,246,617.53.

(c) In determining the amount of appellant's annual revenues and expenses the Commission treated its properties and operations as an integrated whole.

(d) The Commission adopted the sinking fund method for determining what amount would be a reasonable annual accrual to the depreciation and amortization reserve. It

[3] In Texas a rate order of the Railroad Commission is a final legislative act; the courts do not participate in the rate making process.

fixed the amount of $968,066.98, or approximately two per cent of its rate base, as applied to the entire properties.

(e) It found that appellant was entitled to a minimum rate of return of six per cent per annum and that a uniform city gate rate of 32¢ per thousand cubic feet would yield a return of slightly more than six per cent on the value of all of appellant's public service properties as fixed by the Commission.

III.

Date of Judgment and Date of Presentation of Application for Appeal.

1. The judgment of the Court of Civil Appeals for the Third Supreme Judicial District of Texas, sought to be here reviewed, was entered on July 10, 1935. Appellant's Motion for Rehearing was filed within fifteen days, as authorized by Art. 1877, Revised Civil Statutes of Texas, 1925. The Motion was entertained and overruled on September 25, 1935. Thereupon, within the time limited by applicable statutes (Arts. 1728, 1729 and 1742, Revised Civil Statutes of Texas, 1925), appellant petitioned the Supreme Court of Texas to grant a writ of error and review the case. The Petition was refused by the Supreme Court on October 6, 1936.

Appellant thereupon, within fifteen days, as is authorized by Rule 4 of the Rules of the Supreme Court of Texas, filed its Motion for Rehearing of the Application for Writ of Error. This Motion for Rehearing was entertained by the Supreme Court of Texas and was overruled on December 30, 1936. Whereupon the judgment of the Court of Civil Appeals, here sought to be reviewed, became final under the State law.[4]

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[4] When a Petition for Writ of Error is filed, the Petition and the original record are forwarded by the Clerk of the Court of Civil Appeals to the Clerk of the Supreme Court (*Art.* 1743, *Revised Civil Statutes of Texas,*

The Court of Civil Appeals has possession of the record and is the "highest court of the State in which a decision in the suit could be had." The following are examples of cases brought here from courts of civil appeals in Texas: *T. & N. O. R. Co.* v. *Sabine Tram Co.*, 227 U. S. 111; 113; *St. L., S. F. & T. R. Co.* v. *Seale*, 229 U. S. 156; *San Antonio & Aransas Pass R. Co.* v. *Wagner*, 241 U. S. 476; *Zucht* v. *King*, 260 U. S. 174.

2. The date on which this application for appeal is presented is February 12, 1937.

IV.

The Nature of the Case and of the Rulings of the State Court Bringing This Case Within the Jurisdiction of This Court.

Under this heading will also be shown *when* and *how* the Federal questions sought to be reviewed were raised; the method of raising them; and the way in which they were passed upon by the State Court, as required by *Amended Rule* 12.

Nature of the Case.

In this suit appellant challenges, on grounds arising under the Federal Constitution, the rate order of the Texas Railroad Commission, copied under heading II.

The litigation originated in a suit filed September 22, 1933, by appellant in the United States District Court for

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1925). The record is retained in the Supreme Court for fifteen days after the Petition is refused, awaiting the filing of a Motion for Rehearing, and then until the Court has overruled any such motion that may be filed. It is then returned to the Court of Civil Appeals (Rule 4, Supreme Court). The mandate of that Court cannot be issued until the record has been returned and that Court has been properly advised of the action of the Supreme Court on the Petition (Rule 66, Court of Civil Appeals).

True copies of the court rules here referred to are appended as Appendix "C".

the Western District of Texas seeking to enjoin the enforcement of the rate order in question as being violative of the Federal Constitution in the respects hereinafter pointed out. The Commission, joined by the State of Texas and the Attorney General thereof, then filed this suit against the appellant in the State court in an effort to bring appellant within the jurisdiction of the State court, as provided in Section 266 of the Judicial Code (28 U. S. C. A., Sec. 380), alleging in their Second Amended Original Petition, upon which the trial was had, that they desired to have the constitutional questions raised by appellant in its attack on the rate order determined in the courts of the State. (Paragraph IX.)

In the State court suit appellees sought an injunction, upon final hearing, restraining appellant from violating the rate order and further asked that the enforcement of said order be stayed pending final judgment. The stay order was entered in the State court and subsequently the Federal Court, conforming to what it deemed proper procedure under Section 266, entered an order staying all proceedings in that Court and restraining the enforcement of the rate until final determination of this cause. (Order of Federal Court Staying Proceedings.)

Appellant, after unsuccessfully resisting this procedure and reserving its exceptions, answered in the State court setting up its defenses to and attack upon the rate order, grounded on the Federal Constitution, and the trial was there had.

The grounds of attack on the rate order are, first, that the transportation, sale and delivery at wholesale to local distributing companies, through high pressure lines, at city gates in Texas, of gas originating on appellant's lines in the State of Oklahoma, as well as of gas produced in Wheeler County, Texas, and brought into and across Oklahoma into Texas, constitutes interstate commerce and

that the attempted regulating and fixing of appellant's rates of charges for gas thus transported and delivered violates the Interstate Commerce Clause of the United States Constitution; and, second, that the rates are confiscatory and repugnant to the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

The case was tried to a jury, the Court submitting to the jury the following special issue:

> "Do you find from the evidence in this case that, as applied to points in Texas, the order of the Railroad Commission of Texas bearing date of September 13, 1933, providing for a rate of not exceeding 32¢ per thousand cubic feet of gas sold to the distributing companies at the gates of points served, is unreasonable and unjust as to the defendant Lone Star Gas Company? Answer this question yes or no."

The jury answered: "Yes."

In submitting this issue the trial court instructed the jury that appellant was entitled to "a fair return at this time on the present fair value of its property that is used and useful in the public service after first deducting all necessary operating expenses and a fair and reasonable amount for depreciation of said property." The court further instructed the jury that "an unreasonable and unjust rate" was one "so low as to have not provided for a fair return upon the fair value of defendant's property used and useful in supplying the service furnished by said defendant."

The charge further defined the terms "fair value," "fair return," "used and useful," "operating expenses," "annual depreciation," "reproduction cost new," and "going value."

The jury's verdict, interpreted in the light of the charge, imports that the prescribed rate would not yield a fair

return on the fair value of appellant's public service properties and is therefore confiscatory.

On this verdict the trial court rendered judgment enjoining the prescribed rate.

On appeal, the Court of Civil Appeals, after stating and discussing at length appellant's attacks on the rate order, based on the Commerce and Due Process Clauses (Appendix "A", overruled same, reversed the judgment of the trial court and sustained the validity of the Commission's rate order in all respects. The Court's opinion was not based upon any non-federal ground.

Certain other questions arose initially in the Court of Civil Appeals in connection with that Court's disposition of the constitutional issue of confiscation tendered by the appellant, and its rulings in that connection are challeged by appellant as amounting to a violation of the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

NATURE OF THE RULINGS OF THE STATE COURT BRINGING THIS CASE WITHIN THE JURISDICTION OF THIS COURT.

1. *Questions Arising and Rulings Made in Connection With Appellant's Defense Grounded on the Commerce Clause.*

Appellant owns and operates 4,000 miles of high pressure trunk pipe lines located in Oklahoma and Texas, through which it transports natural gas to the city gates of approximately 300 cities and towns in Oklahoma and Texas. At the city gates it sells and delivers the gas in wholesale quantities to distributing companies, most of which are affiliated with it. The distributing companies then sell and deliver the gas to domestic consumers through low pressure lines. The title passes to the distributing companies at the city gate measuring stations.

The sale of the gas at the city gates is governed by long term contracts between appellant and the distributing companies, and the contract price for domestic gas is uniformly 40¢ per thousand cubic feet, with negligible exceptions.

(a) *Gas Produced in Texas Panhandle and Transported Across Western Oklahoma to City Gates in Texas.*—Appellant's pipe line system crosses the State line between Oklahoma and Texas at eight points.[5] Three of these lines, designated as lines "H", "2H", and "G", transport gas from Oklahoma to Texas. Three lines transport gas from Texas to Oklahoma. Another line, designated as line "A", extends from the Shamrock gas field in Wheeler County, Texas, eastward into the State of Oklahoma and thence runs south approximately parallel to the west line of Oklahoma (supplying Hollis, Oklahoma), and again crosses the State line, entering Texas near Quanah. Thence it extends southeastward in Texas and furnishes the exclusive gas supply, without any commingling, for the Texas cities of Wichita Falls, Iowa Park, Electra, Harrold, Oklaunion, Vernon, Tolbert and Chillicothe. A branch of this line extends from Oklaunion, Texas, back into the State of Oklahoma and furnishes the exclusive gas supply of Davidson, Manitou, Frederick, Tipton, Snyder, and Mountain Park, in Oklahoma.[6]

The gas moves to the city gates through line "A" without any interruption. The quantity transported through this line across western Oklahoma is definitely known and was found by the Court of Civil Appeals to be seventeen

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[5] A map of appellant's pipe line system is attached hereto and designated as Appendix "D".

[6] The Court of Civil Appeals states in its opinion that this Wheeler County gas furnishes the gas supply for only one Oklahoma town, Hollis. The finding is erroneous because it ignores the towns on the branch line extending from Texas into Oklahoma (see Map, Appendix "D").

per cent of the total annual sales of gas made by appellant at Texas cities and towns.

After passing Wichita Falls this line is tapped at Petrolia, Texas, by trunk lines "H" and "2H" transporting gas produced or purchased in Oklahoma. Further south and east the line is tapped by other lines lying wholly in Texas and transporting intrastate gas. The commingled gas is then transported and delivered to other Texas cities and towns. The amount of gas originating in line "A" and becoming thus commingled is definitely known.

(b) *Gas Originating in Oklahoma and Transported to Texas.*—In addition to the Wheeler County gas transported through Oklahoma, appellant produces or purchases gas in Oklahoma gas fields and transports same in a southeasterly direction through its 16" high pressure trunk line "G", entering the State of Texas at a point north of Gainesville. Other Oklahoma gas produced or purchased by appellant is transported in its high pressure 16" trunk lines "H" and "2H", entering Texas near Petrolia. The Oklahoma gas transported to Texas in these three lines is sold and delivered to local distributing companies at city gates in Texas.[7]

This gas is run through gasoline plants, part of it at Petrolia and part of it at Gainesville. The forward movement of the gas is not interrupted or arrested when it passes through the plants. The gas enters the bottom of large cylindrical tanks and comes in contact with a mineral oil having a high attraction for hydrocarbons and, by this contact, the hydrocarbons are absorbed and the gas passes out of the absorbers directly into the lines with no interruption in movement.[8]

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[7] The part of the gas brought to Texas in line "G" is carried back to Oklahoma on a branch line extending north from Gainesville and serving the cities of Durant, Caddo and Achille, in Oklahoma.

[8] No part of the Wheeler County gas, transported across western Oklahoma through line "A", is run through gasoline plants in Texas.

The gas transported into Texas through lines "H" and "2H" is compressed at Petrolia and the gas transported into Texas through line "G" is compressed at Gainesville. The compression is merely for the purpose of boosting the pressure and increasing the forward movement of the gas through the trunk lines to the city gates.

As written and as interpreted and enforced in this suit, and otherwise, by the Commission and by the Court of Civil Appeals, the rate order applies to all sales of gas by appellant at city gates in Texas.

(c) *The Interstate Commerce Defense Was Expressly Pleaded.*—Appellant duly pleaded in the court of first instance, and throughout the progress of the case has contended, that it was engaged in interstate commerce in transporting, selling and delivering gas at wholesale to local distributing companies in Texas and that the rate order was void because amounting to a direct regulation of interstate commerce, in violation of the Commerce Clause of the National Constitution; and, further, that said order, being indivisible, was void in its entirety.

Appellant averred that the Commission in its findings and order had considered and valued its entire properties as an integrated whole, making no effort to distinguish as between interstate and intrastate properties or business of appellant (Sec. E, subsec. 3); and that the rate order was unconstitutional and void because the Commission was undertaking to fix its rates "in relation to all of its business including its interstate business" and that a substantial portion of the natural gas sold and delivered by it to distributing companies was gas transported "by defendant in interstate commerce, national in its character," and that the rate order of the Commission

> "unlawfully denies to defendant the free right to sell from its transportation system its natural gas so continuously transported in interstate commerce and un-

lawfully deprives defendant of the rights guaranteed to it by Article 1, Section 8, Clause 3 of the Constitution of the United States, and imposes upon defendant an unreasonable regulation, and places an undue and direct burden upon, and constitutes a direct interference with interstate commerce." (Sec. E, subsecs. 10(b), 10(c).)

Appellant further asserted that said order was void in its entirety, alleging in this connection:

"The said opinion and order were entered and promulgated by the Railroad Commission of Texas and the members thereof, with the intent and purpose of fixing the city gate price which defendant could charge all distributing companies for all domestic gas transported and sold by defendant, whether in interstate or intrastate commerce. That said order in respect of defendant's interstate business is void, as being violative of the Commerce Clause of the Constitution of the United States; and that said order being void in part and indivisible, is therefore void in its entirety, and is not capable of being enforced against the defendant in respect of its intrastate business only." (Sec. E, subsec. 10(j).)

The trial court rendered judgment in favor of appellant on a jury finding that the rate was "unreasonable and unjust."[9]

The present appellees then prosecuted their appeal to the Court of Civil Appeals. Appellant (being then appellee) submitted its counter-proposition in its brief, in conformity to the State practice, asserting that the rate order was void because amounting to a regulation of interstate commerce (Counter-Prop. No. 15); and also its cross-assignment of error asking that the judgment of the trial court, enjoin-

[9] As hereinbefore pointed out, this finding, interpreted in the light of the Court's charge, was in effect a finding that the rate was confiscatory, pp. 8-9, *supra*.

ing the rate order, be affirmed because that court erred in denying appellant's request to instruct a verdict in its favor upon the ground that the rate order was void in its entirety, being violative of the Commerce Clause (Cross-Assignment No. 2).

The Court of Civil Appeals affirmatively found that appellant's defenses based on the Commerce Clause were duly raised. We quote from its opinion:

> "Appellee alleged that the rate order was violative of the commerce, the due process, the equal protection, and the freedom of contract clauses of the Federal Constitution (article 1, sec. 8, cl. 3; Amend. 14); and was confiscatory and unreasonable and unjust because it would not afford a reasonable return on the fair value of its property used in the public service." (Appendix "A", p. 40).

The Court further said:

> "1. Three constitutional objections are urged against the 32¢ rate order as follows:
> "(a) Interference with interstate commerce.
> "(b) Interference with the right to contract.
> "(c) Confiscation of property." (Appendix "A", p. 41.)

(d) *Rulings of the State Court on Appellant's Interstate Commerce Defense.*—The Court of Civil Appeals upheld the rate order as against appellant's attack thereon, duly pleaded and based on the Commerce Clause of the Federal Constitution. Error was duly assigned as to this ruling of the Court in appellant's Motion for Rehearing (Assignments Nos. 125 and 126; see also 104, 107, 108, 110, 113 and 119). The Motion being overruled, the ruling was then complained of in the Petition for Writ of Error filed in the Supreme Court of Texas. (Petition, Assignments Nos. 58 and 59; see also, 1, 2, 3, 4, and 6). The Petition being refused, the same ruling was complained of in the motion for

Rehearing filed in the Supreme Court of Texas (Motion, Assignment No. 58; also 1, 2, 3, 4, 5, 6, 7, 8, and 10).

In overruling appellant's attack on the rate order grounded on the Commerce Clause of the Federal Constitution, the Court of Civil Appeals made the following other rulings, which were duly complained of as is now shown:

(1) That the transportation of gas by appellant from Wheeler County, Texas, across the State of Oklahoma to city gates in Texas "is not interstate commerce as a matter of fact." (Appendix "A", pp. 52-54). Appellant in its Motion for Rehearing specifically assailed as erroneous the ruling of the Court of Civil Appeals that the transportation of gas from Wheeler County, Texas, through Oklahoma into Texas "is not interstate commerce as a matter of fact." (Motion, Assignment 104); the same point was raised in other grounds of the Motion (Assignments 119, 108, 125, 126; in Assignments 125 and 126 the Commerce Clause was expressly referred to.) The Motion for Rehearing being overruled, the same question was raised in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments 1, 2, 3, 4, 58, 59). The Petition being denied, the question was again raised in the Motion for Rehearing filed in that Court (Motion, Assignments 1, 2, 58).

(2) That the gas "produced or purchased by appellee (now appellant) in Oklahoma and transported by its pipe line to Texas does not move in interstate commerce when it reaches the city gates of delivery." (Appendix "A", p. 55. Appellant in its Motion for Rehearing specifically assigned error complaining of this ruling that "the gas produced or purchased by appellant in Oklahoma and transported by its pipe lines to Texas does not move in interstate commerce when it reaches the city gates in Texas for

delivery." (Motion, Assignment 113). The same question was raised in other grounds of the Motion, (Motion, Assignments 114, 115, 125, 126; the Commerce Clause being expressly invoked in 125 and 126). The same question was raised in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments 6, 7, 8, 58, 59); and in the Motion for Rehearing filed in that Court (Motion, Assignments 7, 8, 9, 10, 58).

(3) The State Court further held that the State of Texas might validly fix reasonable rates to be charged upon the sale and delivery of this gas at the city gates in Texas, even if it should be regarded as interstate gas; and that the fixing of such rates did not amount to a direct burden upon, or regulation of, interstate commerce. (Appendix "A", pp. 53-55, and 59-60.) This ruling was duly complained of in the Motion for Rehearing as involving a Federal question (Motion, Assignments Nos. 120, 121, 122, 125 and 126). The Motion being overruled, the same question was raised in the Petition for Writ of Error filed in the Supreme Court (Petition, Assignments Nos. 58, 59; also 4); and in the Motion for Rehearing filed in that Court (Motion, Assignments Nos. 5, 4, 10 and 58).

2. *Ruling Involving a Denial of Adequate Judicial Review of the Rate Order.*

The Court of Civil Appeals held, in effect, that, in a judicial review of the rate order in question, it was the duty of the reviewing court to sustain the rate order if any substantial evidence was offered at the trial in support of the order; the court thus, in effect, holding that the reviewing court was without power to weigh the evidence and settle the conflicts in the evidence and pass its independent judgment on the facts as well as the law relating to and underlying the issue of confiscation. (Appendix "A", pp.

65-66, 71-72, 77-79.) This ruling of the court was duly challenged as involving a denial to the appellant of the right to that adequate judicial review of the rate order that is secured to it by the Due Process Clause of the Fourteenth Amendment to the Federal Constitution; and further upon the ground that, with adequate judicial review thus denied, the order became void and its enforcement against appellant will deprive it of its property without due process of law in violation of the Fourteenth Amendment to the Federal Constitution (Motion for Rehearing, Assignments Nos. 1, 2, 3, 5, 6, 8 and 12; Petition for Writ of Error filed in the Supreme Court of Texas, Assignments Nos. 14, 43, 44, 45 and 60; Motion for Rehearing of said Petition for Writ of Error, Assignments Nos. 17, 18, 19, 50, 51).

3. *Questions Arising and Rulings Made in Connection With the Issue of Confiscation.*

(a) *Rulings Relating to Appellant's Alleged Failure to Make a Proper Segregation of its Properties and Operations as Between Interstate and Intrastate Commerce.*— In valuing appellant's properties located in Oklahoma and Texas and in considering and determining its proper operating revenues and expenses and proper annual reserve accrual for depreciation and amortization the Commission dealt with appellant's properties and operations as an "integrated system" and made no segregation as between interstate and intrastate commerce. Similarly, the Commission ordered the reduced rate to be applied to all deliveries by appellant in Texas, making no segregation as between interstate and intrastate commerce. The Commission's findings have already been summarized, pages 4-5, *supra*.

In the court of first instance, appellant pleaded, and throughout the progress of the case has contended, that the enforcement of the rate order would deny to it a fair re-

turn on the fair value of its public service properties and deprive it of its said properties without due process of law, in violation of Section I of the Fourteenth Amendment to the United States Constitution, and that accordingly said rate order was unconstitutional and void. (Second Amended Answer, Sec. E, subsecs. 10, 12.)

After setting out its specific grounds of attack on the rate order, appellant in its Answer averred that "for each and every one of the reasons aforesaid, the rate or price that the said order of the Railroad Commission of Texas requires it to charge the various distributing companies * * * is confiscatory of its property used and useful in the public service * * * and the enforcement of said order necessarily will deprive defendant of its property devoted to public service and used and useful therein without due process of law * * *, all in violation of its rights under the Constitution of the United States and especially in violation and contravention of the Fourteenth Amendment." (Sec. E, subsec. 12.)

The State court, after stating that appellant had assailed the order as confiscatory, thus interpreted its pleadings:

> "The rate was alleged to be so because it would not afford a reasonable return on the fair value of the property used in the public service of delivering gas to the various city gates, and amounted to taking the property without just compensation or due process of law, in violation of the Fourteenth Amendment to the Federal Constitution." (State Court's Opinion, Appendix "A", p. 61.)

In showing that the rate was confiscatory appellant alleged specifically:

(1) That the present fair value of its entire properties to which the Commission had assigned an over-all value of $46,246,617.53, was more than $70,000,000.00, or approxi-

mately $23,000,000.00 in excess of the value found by the Commission. (Second Amended Answer, Sec. E, subsecs. 6, 8.)

(2) That a sum of not less than $3,400,000.00 was a "fair minimum annual allowance for a depreciation, depletion and amortization reserve charge" as against the allowance of only $983,698.43 in the Commission's findings. (Sec. E, subsecs. 6(f), 8.)

(3) That the appellant was not earning a fair return on the fair value of its property above set out, after making a proper allowance for depreciation, depletion and amortization, under the prevailing 40¢ rate and that at the reduced rate of 32¢ its property would be further confiscated, in violation of its rights under the Fourteenth Amendment to the United States Constitution. (Sec. E, subsec. 8.)

(4) That said order was confiscatory under the Commission's own findings; here the Answer sets forth the details. (Sec. E, subsec. 6.)

(5) That the Commission in its findings had refused to include in the rate base certain described items of property used and useful by the appellant in its public service business and had excluded certain operating expenses actually and normally incurred by the appellant in the conduct of its business, with the effect of depriving it of its property without due process of law, in violation of the Fourteenth Amendment to the Federal Constitution. (Sec. E, subsec. 10(h).)

(6) That the Commission had failed to include in its rate base, as shown by its order and opinion, any amount of "going value." (Sec. E, subsec. 6(d).)

(7) That a six per cent rate of return is confiscatory.

Appellant introduced evidence directly responsive to and assailing the Commission's findings as these findings were

made. This evidence fully supported the allegations of its pleadings just above set out as to the (a) fair value of its properties; (b) proper annual depreciation reserve accrual; (c) proper operating expenses; (d) proper rate of return; and (e) the confiscatory operation of the rate order.[10] This evidence clearly negatived the correctness of the Commission's findings and, if accepted as true, established that the reduced rate was confiscatory.

Appellees offered no rebuttal evidence applicable to the over-all properties and operations covered by the Commission's findings and by appellant's evidence just referred to. The issue here was drawn simply between the Commission's findings and the appellant's evidence relating to the properties and operations in both Oklahoma and Texas considered as a unit.

Having introduced the evidence just referred to, assailing the Commission's findings as these findings were made, appellant then introduced evidence segregating its properties and operations between interstate and intrastate commerce, basing the segregation on the way in which the properties were used and its business conducted. From this evidence, showing the fair value of the segregated properties and operating revenues and expenses applicable thereto and adopting the Commission's allowance for reserve accruals, it appeared that the prescribed rate was confiscatory, yielding an annual return of only 3.78 per cent on the present fair value, and 4.65 per cent on the actual cost, of the segregated properties employed in intrastate commerce.

Appellees offered no evidence in rebuttal of appellant's evidence last referred to as applied to the properties and

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[10] This evidence showed an over-all fair value of properties amounting to $69,738,021.16 against the Commission's rate base of $46,246,617.53, and an annual depreciation reserve accrual of $3,465,123.36 against the Commission's estimate amounting to $983,698.43.

operations identified by appellant's segregation. Instead, appellees attempted to sustain the rate order by showing an entirely different segregation of appellant's properties and operations—a segregation based on geographical location of properties. They assigned the properties located in Texas to Texas and the properties located in Oklahoma to Oklahoma, with unimportant exceptions. (Appendix "A", p. 69-70.)

On appeal the Court of Civil Appeals held that appellant's evidence relating to its over-all properties and operations "proved nothing material to this case" and that said evidence was of no legal value and was insufficient as a matter of law "to establish the invalidity of the rate as being confiscatory (Appendix "A", p. 70-71) because said evidence was not based on a proper segregation of appellant's properties and operations as between interstate and intrastate commerce.[11]

Such being the view of the court, it made no findings settling the conflict between appellant's evidence, relating to its properties and operations considered as a whole, and the Commission's findings relating to the same properties and operations.

The court further held that appellant's evidence tendered on the issue of confiscation, and showing a segregation of its properties and operations as between interstate and intrastate commerce, was immaterial to any issue involved in the case because, in the view of the court, the segregation was erroneous in that it was based upon the assumption that the Wheeler County gas was interstate gas as well as on the assumption that the Oklahoma gas transported to Texas was interstate gas, whereas, under the court's dis-

[11] The Court here, in effect, condemned the Commission's findings made in support of the rate order as being insufficient to support the order because these findings were not based on any segregation, and the prescribed rate applied to all sales of gas in Texas whether made in interstate or in intrastate commerce.

position of the interstate commerce issue, all of this gas was intrastate gas. (Appendix "A", pp. 70-71.)

The court further approved the segregation of appellant's properties and operations under the geographical standard sponsored by appellees, assigning the Texas properties to Texas and the Oklahoma properties to Oklahoma. It approved the rate base of $40,256,862.39 applicable to the Texas properties thus segregated, same being approximately $5,000,000.00 lower than the rate base of the Commission. (Appendix "A", p. 69-70.)

In its Motion for Rehearing appellant assigned error as to the ruling of the Court of Civil Appeals that its evidence, introduced to show confiscation of its properties, "proved nothing material to this case" and that it had failed to furnish the "quantum and character of proof necessary to establish the rate as being confiscatory"; and also assigned error as to the ruling of said court that its segregation of its properties and operations as between interstate and intrastate commerce was erroneous and that the evidence it introduced on the issue of confiscation, based upon such segregation, "proved nothing material to this case" and did not constitute the "quantum and character of proof necessary to establish the invalidity of the rate as being confiscatory" (Motion, Assignments Nos. 89, 80, 81, 83, 85, 86, 87, 47, 156). The same rulings were complained of in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments Nos. 32, 33, 34, 15, 16); and in the Motion for Rehearing filed in the Supreme Court of Texas (Motion, Assignments Nos. 21, 28, 29, 30, 31).

Appellant further assigned error as to the holding of the court approving the rate base of $40,256,862.39 and the geographical segregation of appellant's properties and operations sponsored by appellees' witnesses (Motion, Assignments Nos. 31 and 67). The same ruling was com-

plained of in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments Nos. 11 and 20); and in the Motion for Rehearing filed in the Supreme Court of Texas (Motion, Assignments Nos. 13, 25).

(b) *Additional Rulings on Confiscation Issue.*[12]—In upholding the rate fixed by the Commission as against appellant's charge of confiscation under the Due Process Clause of Section I of the Fourteenth Amendment to the Constitution of the United States the Court of Civil Appeals

(1) Adopted the results obtained by appellees' witnesses on the trial based, in the main, upon the geographical segregation of appellant's property and business as between Texas and Oklahoma, and adopted the determination of property value, operating expenses and revenues made by such witnesses, thereby approving:

a. The elimination from the rate base of the value of appellant's production system property consisting of natural gas reserves, both producing and non-producing, gas wells, gas well equipment, drilling tools and equipment used and useful in the public service in Texas, all of such property costing approximately $5,200,000.00; which ruling was complained of in the Motion for Rehearing (Motion, Assignments Nos. 39, 66 and 158); and in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments Nos. 10, 18); and in the Motion for Rehearing filed in the Supreme Court of Texas (Motion, Assignments Nos. 12, 15, 20).

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[12] These rulings were complained of at the earliest opportunity by appellant in its Motion for Rehearing in the Court of Civil Appeals, and its assignments of error based thereon, and on the judgment of the Court sustaining the rate, were perpetuated in its Petition for Writ of Error in the Supreme Court of Texas and in its Motion for Rehearing in that Court, as hereinafter shown in each instance.

b. The elimination of all expense actually incurred in good faith in the operation of such property amounting to the sum of $232,759.70 for 1933 and $222,752.66 for the twelve months period ended March 31, 1934; which ruling was complained of in the Motion for Rehearing (Assignments Nos. 59, 159); and in the Petition for Writ of Error filed in the Supreme Court of Texas (Assignments Nos. 18, 19); and in the Motion for Rehearing filed in the Supreme Court (Assignments Nos. 14, 15).

c. The failure to make any allowance for depreciation, depletion and amortization of such properties, although appellees' own testimony showed that $94,000.00 per annum would be required; which ruling was complained of in the Motion for Rehearing (Motion, Assignments Nos. 154, 162, and 41); and in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments Nos. 36, 10 and 19); and in the Motion for Rehearing filed in the Supreme Court (Motion, Assignments Nos. 12 and 38).

d. An addition to operating expenses, in lieu of items a, b and c above, of $212,031.46 for the year 1933 and $232,644.75 for the twelve months ended March 31, 1934, such sums being arrived at by applying the average well head price paid by appellant to independent producers to the volume of gas produced by appellant from its own Texas gas reserves during said periods. The sum arrived at by the use of this arbitrary formula was insufficient by approximately $426,000.00 to provide for actual operating expenses, depreciation, depletion and amortization (the latter three items as estimated by appellees' witnesses) and a six per cent return (which the Commission held was the minimum to which appellant was entitled) on the actual cost of such property; which ruling was complained of in the Motion for Rehearing (Motion, Assignments Nos. 41, 42); and in the Petition for Writ of Error filed in the Supreme Court

of Texas (Petition, Assignments Nos. 10, 19); and in the Motion for Rehearing in the Supreme Court (Motion, Assignments Nos. 12, 14).

e. The elimination from the rate base of appellant's property located in Oklahoma actually and necessarily used and useful in transporting to Texas for sale and delivery therein, gas purchased and produced in Oklahoma, being more than fifty per cent of all of appellant's property in Oklahoma actually costing in excess of $6,000,000.00; which ruling was complained of in the Motion for Rehearing (Motion, Assignments Nos. 37, 67); and in the Petition for Writ of Error filed in the Supreme Court (Petition, Assignment No. 20); and in the Motion for Rehearing filed in the Supreme Court (Motion, Assignment No. 25).

f. The elimination of all expenses actually and in good faith incurred in the operating of such properties and the failure to make any allowance whatever for depreciation, depletion and amortization on such properties; which ruling was complained of in the Motion for Rehearing (Motion, Assignments Nos. 51, 154, 162); and in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignment No. 36); and in the Motion for Rehearing in the Supreme Court of Texas (Motion, Assignment No. 38).[13]

g. The arbitrary addition to appellant's actual revenues of $441,240.12 for the year 1933 and $268,829.65 for the twelve months ended March 31, 1934, to compensate for assumed deficiencies in actual gas sales due to alleged abnormally warm weather; which ruling was complained of in the Motion for Rehearing (Motion, Assignments Nos. 40, 163);

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[13] In lieu of e and f above, the Court approved an addition to operating expenses for the year 1933 of $29,617.92 (a so-called Texas-Oklahoma gas sales adjustment), which sum was insufficient to cover actual operating expenses on such property much less provide for depreciation, depletion, amortization and a fair return.

and in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignment No. 61); and in the Motion for Rehearing in the Supreme Court of Texas (Motion, Assignment No. 60).

The reduced rate would have permitted appellant to earn not more than five per cent on the fair value of its Texas public service properties, as determined by appellees' witnesses upon the trial, if appellant's production system property be included in said evaluation and if actual operating expenses thereon and revenues therefrom be allowed, and if effect be given to appellees' estimate for annual reserve accruals for depreciation, depletion and amortization, and thus was shown to be confiscatory by appellees' own evidence.

(h) An annual reserve accrual for depreciation, depletion and amortization of $831,946.08, insufficient for future requirements without making use of an assumed credit balance in the reserve account of $5,000,000 at the date of the inquiry; which ruling was complained of in the Motion for Rehearing (Motion, Assignment No. 52); and in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignment No. 35); and in the Motion for Rehearing filed in the Supreme Court of Texas (Motion, Assignment No. 37).

(2) Approved an allowance of $831,946.08, sponsored by appellees' expert witnesses, same being applicable only to appellant's Texas properties, and being approximately $150,000 less than the Commission's allowance of $983,698.43 applicable to appellant's Texas and Oklahoma properties as a whole.[14] Appellant's evidence showed that an allowance

[14] In its Opinion the Court refers to this as being the Commission's estimate. (Appendix "A", p. 72. The statement is erroneous. This estimate was made, not by the Commission, but by certain witnesses testifying for the Commission at the trial. The Commission made no findings as to what the depreciation allowance should be as applied to appellant's

of $3,465,123.36 was necessary. The Court's rulings in respect to an annual allowance for depreciation, depletion and amortization were duly challenged in appellant's Motion for Rehearing (Motion, Assignments Nos. 49, 50, 52, 53, 162); and in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments Nos. 25, 26, 35, 36); and in the Motion for Rehearing filed in the Supreme Court of Texas (Motion, Assignments Nos. 37, 38, 39, 40).

(3) Approved the elimination from the rate base of an allowance to cover going concern value. This ruling was duly challenged in appellant's Motion for Rehearing as involving a denial of due process of law in violation of the Fourteenth Amendment (Motion, Assignments Nos. 60, 61); and in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments Nos. 30, 31); and in the Motion for Rehearing filed in the Supreme Court of Texas (Motion, Assignments Nos. 41, 42).

(4) Approved a six per cent return as nonconfiscatory. Appellant introduced evidence showing clearly and conclusively that a much higher rate of return was reasonable and actually required, considering the hazards of the natural gas business. This ruling of the Court was duly challenged in the Motion for Rehearing (Motion, Assignments Nos. 62, 63, 64, 160); and in the Petition for Writ of Error filed in the Supreme Court of Texas (Petition, Assignments Nos. 27, 28, 29); and in the Motion for Rehearing filed in the Supreme Court of Texas (Motion, Assignments Nos. 43, 44, 45).

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properties located in Texas. None of the Commission's findings related simply to the Texas properties; all of its findings related to the entire properties. In other connections the Court in its opinion refers to the Commission when, under the record, the reference is applicable only to expert witnesses testifying for the Commission.

V.

The Federal Questions Relied on as Sustaining This Court's Jurisdiction are Substantial.

1. *Questions Arising Under the Commerce Clause.*

(a) The gas produced in Wheeler County, Texas, and transported in a high pressure line into and through Oklahoma back into Texas for sale and delivery at wholesale at city gates in Texas is interstate gas; its transportation, sale and delivery constitute interstate commerce in fact, and, therefore, in law. The interstate character of the transportation and sale of this gas is not affected by the fact that the point of origin and point of terminus lie in the same State. The opinion of the State Court is in direct conflict with the opinion of this Court in *Hanley* v. *K. C. S. R. Co.*, 187 U. S. 617; and also *Western Union Telegraph Co.* v. *Speight*, 254 U. S. 17; *Missouri Pacific R. Co.* v. *Stroud*, 267 U. S. 404; *State Tax Commission* v. *Interstate Natural Gas Co.*, 284 U. S. 41.

Lehigh Valley Ry. Co. v. *Pennsylvania*, 145 U. S. 192, on which appellees rely, is distinguishable for the reasons pointed out in *Hanley* v. *K. C. S. R. Co.*, 187 U. S. 617, 621.[15]

It is immaterial to inquire whether it was necessary for appellant to construct this line through Oklahoma or to consider its reasons for doing so. *Western Union Telegraph Co.* v. *Speight*, 254 U. S. 17; *Missouri Pacific R. Co.* v. *Stroud*, 267 U. S. 404.

(b) The interstate transportation of this gas in high pressure lines does not end until the gas is delivered by appellant at the city gates into the low pressure local lines

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[15] All the later decisions have carefully confined *Lehigh Valley Ry. Co. v. Pa., supra*, to cases involving questions of *taxation*, as distinguished from questions of *regulation*. *Yohn* v. *United States* (2 C. C. A.), 280 Fed. 511; *Willoughby on the Constitution*, Vol. 2, p. 1002; *Gavit, The Commerce Clause*, p. 109.

of the distributing companies purchasing same. *Missouri* v. *Kansas Natural Gas Co.*, 265 U. S. 298; *State Corporation Commission* v. *Wichita Gas Co.*, 290 U. S. 561, 563, 564; *Public Utilities Comm.* v. *Landon*, 249 U. S. 236; *East Ohio Gas Co.* v. *Tax Comm. of Ohio*, 283 U. S. 465.

(c) The State is without power to fix the price that appellant may collect for this gas when delivered at the city gates to distributing companies. The prescribed rate is a direct regulation of interstate commerce. *Missouri* v. *Kansas Natural Gas Co.*, 265 U. S. 298; *State Corporation Comm.* v. *Wichita Gas Co.*, 290 U. S. 561, 563, 564.[16] That the price may be reasonable is immaterial. The question is one of *power*, not of *reasonableness*. *Minnesota Rate Cases*, 230 U. S. 352, 401; *Smith* v. *Illinois Tel. Co.*, 282 U. S. 133, 148. It is enough that the regulation imposed is a direct one. *Cudahy Packing Co.* v. *Hinkle*, 278 U. S. 460, 466; *Alpha Portland Cement Co.* v. *Mass.*, 268 U. S. 203.

The State court erroneously assumed that the fixing of the city gate rate is merely a local police regulation and valid, unless it discriminates against interstate commerce. (Appendix "A", pp. 54-55.) The fixing of the city gate rate is the fixing of the compensation that the utility may exact for the use of interstate facilities. It is a regulation of a matter of national and not merely of local concern. *East Ohio Gas Co.* v. *Tax Comm.*, 283 U. S. 465, 470, 472; *Missouri* v. *Kansas Natural Gas Co.*, 265 U. S. 298, 309.

(d) The failure of Congress to act is immaterial because the rate operates as a direct regulation of interstate commerce. *Missouri* v. *Kansas Natural Gas Co.*, 265 U. S. 298; *State Corporation Comm.* v. *Wichita Gas Co.*, 290 U. S. 561; *Public Utilities Comm.* v. *Landon*, 249 U. S. 236; *Public Utilities Comm.* v. *Attleboro Co.*, 273 U. S. 83, 90.

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[16] The rate order here involved is unlike that involved in *State Corporation Comm.* v. *Wichita Gas Co., supra*, because it fixes the rate and prohibits the pipe line company from charging or collecting any higher rate.

For this reason, the Federal statute, providing that the Interstate Commerce Act shall not apply to gas pipe lines, has no application. That was directly held in *Missouri* v. *Kansas Natural Gas Co.*, 265 U. S. 298.[17]

(e) Corporate affiliation between appellant and the distributing companies (excepting two) does not change the interstate character of the transportation to which the rate directly applies. Transporting the gas to the city gates is interstate commerce in fact without regard to ownership of the facilities used in transporting it. The fixing of the city gate wholesale rate fixes the amount of compensation that the public utility may collect for the use of its property in rendering a public service in interstate commerce. This is none the less true even though the pipe line company and the distributing company may be affiliated. *State Corporation Comm.* v. *Wichita Gas Co.*, 290 U. S. 561, 563, 564 (where the companies were affiliated); *East Ohio Gas Co.* v. *Tax Comm.*, 283 U. S. 465, 470 (where one company owned the trunk line and the distributing facilities).

Western Distributing Company v. *Public Service Comm.*, 285 U. S. 119, 124, is distinguishable because it did not involve any effort to directly fix the city gate rate; it involved only the burner tip rate. The rate order here applies directly against the interstate pipe line and prohibits it from charging any other rate. Its application does not even depend upon corporate affiliation.

Pennsylvania Gas Co. v. *Public Service Commission*, 252 U. S. 23, is not in point because there was involved only the burner tip rate. The business regulated was local and not national in character; that was the ground upon which the

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[17] In that case the State Court held, as did the State Court here, that since Congress had not acted the State had the power to regulate "the sale of natural gas in this State by the Kansas Natural Gas Company." *State* v. *Kansas Natural Gas Co.*, 111 Kansas 809. The decision was reversed in this Court, 265 U. S. 298.

decision was based, as was explained in *Missouri* v. *Kansas Natural Gas Co.*, 265 U. S. 298, 309, and in *Public Utilities Comm.* v. *Attleboro Co.*, 273 U. S. 83, 89. As to that case, see also *East Ohio Gas Co.* v. *Tax Comm.*, 283 U. S. 465, 472.

(f) The commingling of a part of this Wheeler County gas, transported across Oklahoma, with intrastate gas after it arrives in Texas is immaterial since the total quantity transported across Oklahoma into Texas is definitely known—being seventeen per cent of the total amount sold in Texas, as found by the State court. *Peoples Natural Gas Co.* v. *Public Service Comm.*, 270 U. S. 550, 554, 555; *United Fuel Gas Co.* v. *Hallanan*, 257 U. S. 277, 281; *Board of Trade* v. *Olsen*, 262 U. S. 1, 33, 34.

No commingling of this Wheeler County gas takes place until after it has passed Wichita Falls, Texas, going south. It furnishes the exclusive source of supply, uncommingled, for Wichita Falls and the Texas cities and towns lying to the north and west, as well as for Hollis, Oklahoma, and other Oklahoma cities and towns located on the branch line extending north into Oklahoma from Oklaunion, Texas. The rate order is indivisible and applies as well to the uncommingled deliveries made at Wichita Falls and the other Texas cities just mentioned as it does to commingled deliveries made after the gas passes Wichita Falls.

(g) That the amount of this gas (17% of the total amount sold in Texas) may be less than the amount transported by appellant in intrastate commerce is not material for the amount is known and the prescribed rate falls on all gas sold in Texas including this gas. *Peoples Natural Gas Co.* v. *Public Service Comm.*, 270 U. S. 550, 554, 555; *Public Utilities Comm.* v. *Attleboro*, 273 U. S. 83.

Since the rate places a direct burden upon interstate commerce "it is none the less beyond the power of the State

bcause this may be a smaller part of the general business." *Public Utilities Comm.* v. *Attleboro Co.*, 273 U. S. 83, 90. If quantity is controlling, then seventeen per cent is enough; only three per cent was involved in *Public Utilities Comm.* v. *Attleboro Co., supra.*

(h) As written and as interpreted and applied by the Commission and as upheld and enforced by the Court of Civil Appeals, the rate order applies to all city gate sales in Texas whether made in interstate or intrastate commerce. The rate order is an indivisible legislative act. "The order is in terms single and indivisible." *Illinois Central R. R. Co.* v. *McKendree*, 203 U. S. 514, 529. The result is that the order may not be limited to intrastate transactions; to do this would remake it. *Butts* v. *Merchants, etc., Transportation Co.*, 230 U. S. 126, 135; *Employers' Liability Cases*, 207 U. S. 463, 502; *Baldwin* v. *Franks*, 120 U. S. 686, 688; *The Trade Mark Cases*, 100 U. S. 82, 99.

(i) What has been said thus far under this heading has related to the Wheeler County gas. It is now submitted that the gas produced or purchased in Oklahoma and transported to Texas is interstate gas. *Missouri* v. *Kansas Natural Gas Co.*, 265 U. S. 298; *State Corporation Comm.* v. *Wichita Gas Co.*, 290 U. S. 561, 563. None of the grounds relied upon by the State court in support of the rate order, as applied to this case, are tenable.

Running this gas through gasoline extraction plants in Texas does not change its character as interstate gas. This process does not even interrupt its movement. *Carson Petroleum Co.* v. *Vial*, 279 U. S. 95; *Stafford* v. *Wallace*, 258 U. S. 495; *Board of Trade* v. *Olsen*, 262 U. S. 1; *Ohio R. R. Comm.* v. *Worthington*, 225 U. S. 101; *Southern Pacific Terminal Co.* v. *Interstate Commerce Comm.*, 219 U. S. 498, 526 (converting cotton seed cake into meal).

The temporary storage of a small part of the gas, produced or purchased in Oklahoma, in gas wells does not change its character. Furthermore, the rate order is indivisible and applies to all of this Oklahoma gas delivered at city gates whether stored or not; and the State court finds that only a part of it is stored. The fact that a part of the gas might have become intrastate gas because stored will not support an order fixing a city gate rate applicable to all of it, including that not stored.

Inability to trace a known quantity of this gas, after commingling, to any particular city is without effect. At what city in Texas a given quantity may be delivered is not material because it is known that the entire amount is moving in interstate commerce to city gates in Texas and it is all subjected to the same rate operating as a direct burden on interstate commerce. *Peoples Natural Gas Co.* v. *Public Service Comm.*, 270 U. S. 550; *United Fuel Gas Co.* v. *Hallanan*, 257 U. S. 277, 281; *Ohio R. R. Co.* v. *Worthington*, 225 U. S. 101, 107, 108.

(j) The use of a compressor station at Petrolia, Texas, to increase the movement of that part of the gas not delivered at other Texas city gates before reaching Petrolia did not bring the gas "to rest." *Ozark Pipe Line Co.* v. *Monier*, 226 U. S. 555; *Peoples Natural Gas Co.* v. *Public Service Comm.*, 270 U. S. 550; *State Tax Comm.* v. *Interstate Natural Gas Co.*, 284 U. S. 41, 44.

2. *Denial of Adequate Judicial Review.*

To impose on the reviewing court the duty to render judgment upholding the rate order, merely because of the existence of a conflict in the evidence on the issue of confiscation, the court being without power to settle the conflict, is to deny the court the power to pass its independent judgment on the facts as well as the law relating to the

constitutional issue of confiscation. *Ohio Water Co.* v. *Ben Avon Borough,* 253 U. S. 287; *St. Joseph Stock Yards Co.* v. *United States,* 298 U. S. 38 (Preliminary Print); *Baltimore & Ohio R. Co.* v. *United States,* 298 U. S. 349 (Preliminary Print). With the right of judicial review thus defined and limited, the order becomes void and its enforcement operates to deprive appellant of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

3. *Questions Arising Under the Due Process Clause of the Fourteenth Amendment.*

(a) *Necessity for Segregation of Appellant's Properties and Operations as Between Interstate and Intrastate Commerce.*—To deny, as did the Court of Civil Appeals, the right to introduce evidence responsive to, and in conflict with, the findings of the Commission was, in effect, to deny the right to introduce evidence assailing the rate based upon the findings; it was a denial of due process of law, in violation of appellant's rights under the Due Process Clause of the Fourteenth Amendment to the Federal Constitution. *I. C. C.* v. *L. & N. R. R. Co.,* 227 U. S. 88; *West* v. *C. & P. Tel. Co.,* 295 U. S. 662, 667; *West Ohio Gas Co.* v. *Comm.,* 294 U. S. 63, 67.

Appellant, assailing the order, had the burden of showing specifically the invalidating facts. *Ætna Insurance Co.* v. *Hyde,* 275 U. S. 440, 447. It could not do this and ignore the specific findings made by the Commission in support of the order.

Smith v. *Illinois Tel. Co.,* 282 U. S. 133, 148, cited by the State Court, is not applicable in support of the Court's ruling. If appellant is engaged only in intrastate commerce, as held by the Court of Civil Appeals, then no segregation of its properties and operations was necessary. Thus viewing the case, the Commission properly valued all

of its properties, wherever situated, used in furnishing the service to which the rate applied—a service that the State Court held was a local one. *Smith* v. *Illinois Tel. Co.* has no application except where the utility is engaged locally in both interstate and intrastate commerce. On the other hand, if the State Court wrongly decided the interstate commerce question, as appellant contends, then *Smith* v. *Illinois Tel. Co.* is applicable here, but only in support of appellant's segregation of its properties and business—a segregation conforming to the test defined in that case because based upon actual use of the property and conduct of the business.

Smith v. *Telephone Company* is further distinguishable because in that case the rate as prescribed applied only to intrastate transactions, while here the prescribed rate applies to all sales of gas made by appellant in Texas including any sales made in interstate commerce.

Whether a segregation was practical or was necessary was for the Commission to decide in the first instance. It was a question of fact falling within the administration field. *Groesbeck* v. *Duluth S. S. & A. R. Co.*, 250 U. S. 607, 608; *S. W. Bell Tel. Company* v. *San Antonio*, 75 F. (2d) 880, 883, 885.

(b) *Refusal to Approve Appellant's Segregation of Its Properties and Business Operations as Between Interstate and Intrastate Commerce.*—Appellant's segregation of its properties and business as between interstate and intrastate commerce was based upon the manner in which the properties were used and the business conducted. It therefore met the controlling test defined by this Court. *Simpson* v. *Sheppard* (*Minn. Rate Cases*), 230 U. S. 352; *Smith* v. *Illinois Tel. Co.*, 282 U. S. 133; *Missouri Rate Cases*, 230 U. S. 474; *Allen* v. *St. Louis I. M. S. R. Co.*, 230 U. S. 553; *Groesbeck* v. *Duluth S. S. & A. R. Co.*, 250 U. S. 607, 608.

The only objection to appellant's segregation made by the Court of Civil Appeals was one grounded upon the assumed correctness of its rulings in respect to the interstate commerce question. If these rulings were wrong, then the Court's disapproval of appellant's segregation was wrong.

(c) *Elimination From Rate Base of Production System Properties.*—Appellant's production system property consisting of gas wells, gas well equipment, producing and non-producing leases and drilling tools and equipment and appellant's property, located in Oklahoma, but used and useful in producing, transporting and delivering gas to points in Texas being actually used and useful in the rendition of public service in Texas should have been included in the rate base approved by the Court of Civil Appeals. The exclusion of all of such property from the rate base approved by the Court denied appellant a reasonable return upon the fair value thereof and hence denied to appellant due process of law and just compensation, in violation of its rights under the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the Federal Constitution. *McCardle* v. *Ind. Water Co.*, 272 U. S. 400; *Bluefield Water Co.* v. *Public Service Comm.*, 262 U. S. 679; *Board of Commissioners* v. *N. Y. Tel. Co.*, 271 U. S. 23; *West* v. *C. & P. Tel. Co.*, 295 U. S. 662.

(d) The approval by the Court of Civil Appeals of an allowance for annual accruals to depreciation, depletion and amortization reserve which wholly failed to provide anything for depletion of appellant's producing gas reserves—wasting assets—was a denial to appellant of due process of law, in violation of its rights under the Due Process Clause of the Fourteenth Amendment to the Federal Constitution. *Columbus Gas & Fuel Co.* v. *Public Service Comm.*, 292 U. S. 398, 404, 405.

(e) The approval by the Court of Civil Appeals of arbitrary formulas in substitution for an evaluation of, and an

allowance of operating expenses, depreciation, depletion and amortization and a fair return on, appellant's Texas production system properties and properties located in Oklahoma used and useful in the rendition of public service in Texas was a denial to appellant of due process of law and just compensation, in violation of its rights under the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the Federal Constitution. *West* v. *C. & P. Tel. Co.*, 295 U. S. 662; *West Ohio Gas Co.* v. *Comm.*, 294 U. S. 63. Mere calculations and formulas should not be substituted for actual facts and experience; *McCardle* v. *Ind. Water Co.*, 272 U. S. 400, 410, 416, 417; *St. Louis & O'Fallon R. R. Co.* v. *United States*, 279 U. S. 461; *Minn. Rate Cases*, 230 U. S. 352; or actual operating experience and expenses. *West Ohio Gas Co.* v. *Public Utilities Comm.*, 294 U. S. 63.

(f) The addition to appellant's revenues of $441,240.12 for the year 1932, because of assumed abnormal temperature conditions, although the actual weather conditions during the operating period and the actual operating income were known and well established, was arbitrary action, in violation of appellant's rights under the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the Federal Constitution. Preferring prophecy to experience was arbitrary action. *West Ohio Gas Co.* v. *Public Utilities Comm.*, 294 U. S. 79.

(g) The approval by the Court of Civil Appeals of an annual allowance to reserve for depreciation, depletion and amortization, which was based upon the assumed existence and use of a credit balance in the reserve account of approximately $5,000,000.00 at the rate of inquiry, and which allowance was admittedly inadequate unless supplemented by such an assumed reserve, denied to appellant due process and equal protection of the laws, in violation of its rights under the Due Process Clause of the Fourteenth Amendment to the Federal Constitution. *Board of Commissioners*

v. *N. Y. Tel. Co.*, 271 U. S. 23; *Clark's Ferry Bridge Co.* v. *Public Service Comm.*, 291 U. S. 227.

VI.

Cases Believed to Sustain Jurisdiction.

In addition to the cases cited under heading V to show the substantial nature of the Federal questions relied on, the following are cited as sustaining the Court's jurisdiction.

1. *The rate order is a "statute" of the State of Texas.*

King Mfg. Co. v. *Augusta*, 277 U. S. 100, 112;
Lake Erie, etc., R. Co. v. *State Public Utilities Comm.*, 249 U. S. 422, 424.

2. *The appeal is properly taken from the judgment of the Court of Civil Appeals; it is the highest court of the State in which a decision could be had.*

Stanley v. *Schwalby*, 162 U. S. 255, 269;
Sullivan v. *Texas*, 207 U. S. 416, 422;
T. & N. O. R. Co. v. *Sabine Tram Co.*, 227 U. S. 111, 113.

VII.

Opinions Appended.

1. Copy of Opinion of the Court of Civil Appeals (unofficially reported 86 S. W. (2d) 484) is attached as Appendix "A".

2. Copy of Opinion of the same Court on rehearing is attached as Appendix "B".

LONE STAR GAS COMPANY,
By ROY C. COFFEE,
OGDEN K. SHANNON, JR.,
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APPENDIX "A".

Opinion of Court of Civil Appeals.

(Reported 86 S. W. (2d) 484.)

No. 8238.

THE STATE OF TEXAS *et al*, *Appellants*,

vs.

LONE STAR GAS COMPANY, *Appellee*.

Appeal from District Court of Travis County.

Acting under the power conferred by Article 6050, et seq., R. S. 1925, and after a hearing which continued for more than seven months, the Railroad Commission of Texas promulgated its order requiring appellee Lone Star Gas Company to "charge, bill and receive for domestic gas at the city gate from all distributing companies served by it, a rate not to exceed $0.32 per thousand cubic feet", in lieu of the $0.40 rate theretofore charged. Immediately appellee filed a bill of complaint in the Federal District Court, seeking to restrain the enforcement of the rate order on several constitutional grounds, and particularly as being confiscatory of its property. Thereafter, the Commission, Attorney General, and others, herein called Commission, instituted this proceeding in the District Court of Travis County, Texas, in order to bring appellees within the jurisdiction of the state court under the provisions of Sec. 266 of the Judicial Code of the United States (28 U. S. C. A., Sec. 380). The Commission asserted the validity of the order in every particular, and sought to restrain appellee from violating it. In conformity with what was regarded as proper procedure under Sec. 266 of the Judicial Code, both the state and the federal courts temporarily restrained the enforcement of the rate order, and later the federal court ordered all proceedings therein stayed until the final disposition of this cause. Appellee's answer herein, seeking to set aside the rate and restrain its en-

forcement, was in effect an appeal by it under Article 6059, which provides that any gas utility dissatisfied with any rate may petition a court of competent jurisdiction in Travis County and have same set aside, upon showing by "clear and satisfactory evidence that such rate is unreasonable and unjust as to it." Appellee alleged that the rate order was violative of the commerce, the due process, the equal protection, and the freedom of contract clauses of the Federal Constitution; and was confiscatory and unreasonable and unjust, because it would not afford a reasonable return on the fair value of its property used in the public service. In reply, the Commission asserted the validity of the order in every particular, denied that any gas moved in interstate commerce; but that if so, it was negligible in amount and was not affected by the rate; and that in absence of legislation by Congress on the subject, the Commission had the authority under the statutes and in the exercise of the police power of the state to regulate and control public gas utilities, and to fix reasonable rates for gas sold and delivered to its citizens, even though interstate commerce was indirectly or incidentally affected thereby.

The trial court concluded the commerce and all constitutional questions against appellee; but the jury found in answer to the one special issue submitted, that "the order for a rate not to exceed 32 cents per thousand cubic feet of gas sold to the distributing companies at the gates of the points served, is unreasonable and unjust as to the Lone Star Gas Company." Judgment was accordingly rendered setting aside the 32-cent rate order, and perpetually restraining its enforcement.

The special issue submitted, with the definition and instructions given in connection therewith, was in the nature of a general charge, and required the jury to determine all questions of law and fact of the entire case. Under the pleadings of appellee the ultimate question of fact was whether the 32¢ rate would yield a reasonable return on the fair value of the property used in the public service of delivering and selling natural gas to the distributing companies at the city gates of the various Texas cities and towns. Appellee attempted to prove that the 32¢ rate

would not yield a reasonable return, for two reasons, as follows:

1. Because the 32¢ rate would not yield the minimum return of 6% declared to be reasonable by the Commission; and

2. Because if so, a return of 6% was so low as to be confiscatory and unreasonable and unjust.

The burden was heavily upon appellee to show by clear and satisfactory evidence that the 32¢ rate would not afford a reasonable rate of return on the property used in the Texas public service. Appellee did not meet this burden and quantum of proof; and the trial court erred in overruling the Commission's motions for an instructed verdict and for judgment declaring the rate to be valid. In view of this conclusion, the appeal presents two main divisions, as follows:

1. Three constitutional objections are urged against the 32¢ rate order, as follows:

(a) Interference with interstate commerce.

(b) Interference with the right to contract.

(c) Confiscation of property.

2. The legal sufficiency of the evidence adduced by appellee to show that the rate order was confiscatory or unreasonable and unjust as to it.

The Texas statutes, particularly Articles 6050, 6051 and 6053, classify the various kinds of business engaged in producing, transporting, delivering and selling natural gas to the public for domestic or other use, and declare each to be a public gas utility, affected with the public interest and subject to the regulation and control of the Commission. Gas pipe lines engaged in producing, buying, transporting, delivering, or otherwise dealing in natural gas are each declared to be a public utility, affected with the public interest, and in nature and according to the established method of conducting same a monopoly, and subject in respect to all their holdings pertaining to the gas business and in all relations to the public, and in respect to their producing, transporting, receiving and distributing

facilities, to the full and complete control and supervision of the Commission. Authority is also given the Commission to fix, establish and enforce a reasonable rate which pipe lines may charge for gas delivered at the city gate to another distributing company or municipality; to fix a reasonable rate for gas sold and delivered by pipe lines or other distributing companies to the public for domestic or other use; and to fix and establish a fair and equitable division of the proceeds of the sale of natural gas between the producing or transporting companies and the companies distributing or selling it to the ultimate consumer. In the exercise of the power so conferred, the Commission is authorized to act upon its own motion, or upon the petition of any person, corporation, municipality, etc., showing a substantial interest in the subject.

Accordingly the Commission of its own motion, ordered a hearing to investigate the 40¢ city gate rate which appellee uniformly charged the various distributing companies throughout the State for gas. Appellee and each of the approximately 270 cities and towns served by it were given notice of the hearing, after which the Commission made its order fixing the 32¢ gate rate, found to be "fair, just and reasonable", in lieu of the 40¢ rate theretofore charged, found to be "unfair, unjust and unreasonable."

Interstate Commerce Issue.

Appellee obtains its natural gas from two states, which under its system of accounting is allocated to three sources. The first source is gas produced or purchased in Texas and transported and delivered entirely within Texas. As to this gas, appellee admits the authority of the Commission to regulate and fix the price for which it shall be sold at the city gates to the affiliated distributing companies in a proper proceeding; but contends that since the rate order in question also attempts to fix the price of gas transported in interstate commerce, the order is invalid in toto because invalid in part. From this source appellee accounts for about 79% of its total gas supply.

The second source of gas is produced or purchased by appellee in Oklahoma, and transported through its pipe

lines from points of production into Texas. All of this gas is processed and treated in gasoline plants located near Gainesville, Texas, and Petrolia, Texas. At these plants the heating value of this gas is lowered by extracting the gasoline therefrom, and practically all of it is recompressed. When this gas leaves Oklahoma for Texas its exact ultimate destination is not known, and a considerable amount of it is run through and stored in wells at the extraction plants in Texas for future use as needed. Each pipe line transporting this gas has a meter at the State line, for the purpose of measuring the amount thereof. From this source, over the 1927-1933 period considered, appellee accounts for about 4% of its total gas supply. However, the amount of this gas has shown a marked decline until during the last year of the accounting period it amounted to about one-half of 1% of appellee's total gas supply. All of this gas is commingled in storage or pipe lines with appellee's Texas gas before delivery at the city gates. Appellee contends that this gas moved in interstate commerce to the city gates, and is, therefore, not subject to the jurisdiction of the Commission.

The third source of gas is produced or purchased in the Panhandle field in Wheeler County, Texas, and transported by appellee's private pipe line through a corner of Oklahoma (less the amount of deliveries at Hollis, Oklahoma) and back into Texas, uninterruptedly. The Commission alleged and indisputably proved that this pipe line was built through a sparsely settled, rough, rocky region, just within and paralleling the boundary line of Oklahoma, for about 40 miles, recrossing the Texas line at a point on the Prairie-Dog Town Fork of Red River, where an exceedingly expensive crossing was necessary, which would not have been necessary if the pipe line had been constructed by a more direct route within Texas; and that as compared to the Oklahoma route, the Texas route would have been much less expensive, through sandy and less corrosive soil, more direct, and through a more populous region. The Commission contends that the construction of this pipe line was, therefore, fraudulently done for the purpose of attempting to deprive it of jurisdiction over appellee. From

this source of gas appellee accounts for about 17% of the total supply subject to the rate order in question.

The gas reserve of appellee in Oklahoma as compared to those in Texas amounted to about one-fourth of one per cent. The gas reserves in Texas are more than sufficient to supply all Texas needs, and the gas supply of Oklahoma will likewise supply all its needs. The Texas gas used in Oklahoma and the Oklahoma gas used in Texas about strike a balance, and in any event, if the excess should be in favor of Oklahoma, it is negligible. Texas gas is less expensive to produce than Oklahoma gas. Approximately 85% of appellee's property is situated in Texas; and approximately 99% of its gas reserves are in Texas. Gas coming from Oklahoma is so mixed and commingled with Texas gas that it cannot be definitely traced by volume to any particular city gate, because it is divided and redivided into the network of appellee's pipe lines, in amounts which are negligible in comparison with the amount of the Texas gas. Oklahoma produced gas is not served south of Fort Worth or Dallas, nor west of Fort Worth. A very small amount of Oklahoma gas is delivered to independent distributors at Gainesville and Waxahachie. The order does not in any manner interfere with the sale of the Oklahoma gas at the same rate as the Texas gas.

In view of these facts, appellee contends that the order was an attempt to regulate and burden interstate commerce, because a part of the gas affected by the 32¢ rate is produced or purchased in the State of Texas, and transported by the pipe lines of appellee through a corner of the State of Oklahoma and back into Texas, where it is sold and delivered wholesale at the gates of the various Texas cities and towns; and because a part of the gas is produced or purchased in the State of Oklahoma and transported by the pipe lines of appellee uninterruptedly and at high pressure into Texas, where it is sold wholesale at the city gates.

As preliminary and as bearing upon the issues of interstate commerce, the interference with the right to contract, operating expenses, and other issues relating to the jurisdiction of the Commission to regulate and control appellee, it was the theory of the Commission that by reason of an intercorporate setup and affiliation between appellee

and the distributing companies to which it delivered gas at the city gates, an integrated but single business enterprise was established in which appellee and the distributing companies were merely the departments or instrumentalities through which the single business enterprise sold and delivered natural gas to the ultimate consumer or burner tip user. The Commission asserted that the fixing of the gas rate at the city gate under such business setup effectually fixed the rate from the city gate to the burner tip, which was intrastate commerce and subject to the control and regulation of the Commission. It was alleged that the unity or oneness of the business enterprise was accomplished by the combination of property and effort, and through a holding corporation, the Lone Star Gas Corporation, a Delaware chartered corporation, with its principal offices in Pittsburgh, Pa. The facts sustaining this allegation are as follows:

Appellee, Lone Star Gas Company, is in corporate theory a Texas gas pipe line corporation, classified by Article 6050 as a "public utility", and "declared to be affected with a public interest and subject to the jurisdiction, control and regulation of the Commission." By Article 6051, appellee's business is declared to be "a business which in its nature and according to the established method of conducting the business is a monopoly and shall not be conducted unless * * * such business be subject to the jurisdiction herein conferred upon the Commission." In excess of 99% of appellee's common, voting or controlling stock is owned by the Lone Star Gas Corporation, the Delaware chartered corporation, which does not have a permit to do business in Texas.

The affiliated distributing companies material to this case are the Community Natural Gas Company, County Gas Company, Dallas Gas Company, Municipal Gas Company, and Texas Cities Gas Company. Each of these companies is a Texas corporation, and in corporate theory and as classified by Article 6050, each is a "public utility", engaged "in distributing or selling natural gas to the public for domestic or other use," serving one or more of some 270 cities and towns in Texas. The Delaware holding corporation owns in excess of 99% of the common

or voting stock of the affiliated Community Gas Company, County Gas Company, Municipal Gas Company, Texas Cities Gas Company, and, through a subholding corporation, the Dallas Gas Company.

Appellee and all of its affiliated distributing companies have connected offices in Dallas, Texas, and all of these Texas corporations and the Delaware holding corporation have officers and directors common to each corporation, although there is not a majority by number in any instance. Voting by proxy or as attorney in fact is practiced by the interlocking directors and officials of all corporations involved in the intercorporate setup. All Texas corporations confer with and are subject to the management of the Lone Star Gas Corporation, the holding corporation. For these services it exacts a "management fee" of one per cent of the gross annual revenue of appellee, and a "management fee" is also exacted by the holding corporation for each affiliated distributing company. The holding corporation has loaned appellee $17,600,000 on its unsecured note; and loans have been made to each affiliated distributing company either on open account or on unsecured notes. Interest at six per cent. is charged on the $17,600,000 indebtedness of appellee, although the holding corporation borrowed the money at five per cent., and a similar condition exists as to the affiliated distributing companies, notwithstanding some of them are able to borrow large sums from local banks at from four to four and one-half per cent. interest.

All books of all corporations, except the holding corporation, are kept in the offices at Dallas, Texas, and a general or supervising auditor has authority and direction over all books. Accounting services, engineering, financing, purchasing and operating supervision are furnished all Texas corporations by the Delaware holding corporation, and a general counsel represents all the corporations involved in the intercorporate setup.

In its department of the integrated business enterprise, appellee is engaged in producing and purchasing natural gas and in transporting same by its 4000-mile pipe line system from the point of production to the city gates of some

270 cities and towns in Texas, where the gas is delivered to one and the other affiliated distributing companies. A uniform rate of 40¢ at the city gate is made by appellee, which rate it filed with the Commission, and has charged and collected for several years. Appellee has long-term contracts with its affiliated distributing companies for the 40¢ city gate rate.

In their department of the integrated business enterprise, the affiliated distributing companies are engaged in selling and delivering the gas to the burner tips of the consumers, and for which service they charge a fixed rate.

Appellee also furnishes gas at the city gates of Waxahachie and Gainesville, Texas, to two independent distributing companies,—the Waxahachie Gas Company and the Gainesville Gas and Electrical Company; and in Waxahachie, a small amount to its affiliated Municipal Gas Company. The amount of this gas is negligible, in comparison with appellee's total gas business. Each independent distributing company pays the 40¢ city gate rate under long term contracts with appellee.

The cases are legion which deal with the relationship of two or more corporations from the standpoint of ownership of the capital stock in one by another, and from the standpoint of association together for the purpose of carrying on a single or common business enterprise. The rule is well settled that courts will look through the forms to the realities of the relationship between two or more corporations in order to determine whether each is a separate entity or corporation; or whether their commingled affairs are such as to constitute them one integrated and single business enterprise; or whether through intercorporate setup, affiliation or stock ownership, the purpose is to control the subsidiary corporation or corporations so that they are used as the mere instrumentalities or agents of the owning corporation or corporations. In discussing the rule, it has been held that while "ownership alone of capital stock in one corporation by another does not create an identity of corporate interest * * * or create the relation of principal and agent or representative between the two;" still it has been repeatedly held that such rule is not applicable "where

stock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner, but for the purpose * * * of controlling a subsidiary company so that it may be used as a mere agency or instrumentality of the owning company or companies. Chicago Ry. *v.* Minn. Civic Ass'n, 247 U. S., 490, 62 L. Ed. 1229; United States *v.* Lehigh Valley R. R. Co., 220 U. S., 257, 55 L. Ed., 458; United States *v.* Reading Co., 253 U. S., 26, 64 L. Ed., 760; United States v. Delaware L. & W. R. Co., 238 U. S. 516, 59 L. Ed., 1438. Also in discussing the rule the fact that the same persons are directors and managers of two corporations has been given consideration (McCaskill Co. *v.* United States, 216 U. S., 504) and "a growing tendency is therefore exhibited in the courts to look beyond the corporate form to the purpose of it and to the officers who are identified with that purpose." See also Gallatin Gas Co. *v.* Public Service Co., 256 Pac., 373. Where one corporation owns or dominates another it has been often held that "the independent entity of the two companies is so far disregarded that each is considered a part of the invisible whole." Kimberly Coal Co. *v.* Douglas, 45 Fed. (2d) 25; *In re* Kentucky Wagon Mfg. Co., 3 F. Supp. 958; Law *v.* McLaughlin, 2 F. Supp., 601. And "the rule which appears to be established by these cases is that, where the corporate organization and affairs of one railroad company are controlled and dominated by another railroad company through ownership or stock or lease, the roads must be regarded as identical for the purpose of rate making." Pacific Ry. Co. *v.* R. R. Com., 168 N. W., 927, 929.

A somewhat analogous question was decided by this court in A. T. & S. F. Ry. Co. *v.* R. R. Com., 77 S. W. (2d), 773, (writ refused), wherein it was held that subsidiary corporations, owned, controlled and operated by railroads to carry on pickup and delivery service, did not possess separate legal individuality from the parent corporations, as regards the jurisdiction of the Railroad Commission; and wherein it was held as follows:

> "To permit railroads to perform such steps in the process of transportation through other separate legal entities created and owned by them would enable them

to defeat the jurisdiction of the Commission over such transportation. And in such case where the stock of such separate corporation is owned by the railroad company, and its sole function is merely to help conduct the business of the parent corporation under whose complete control it operates, and in the instant case largely, if not wholly, through the same employees, the subsidiary corporation will be treated as if it were a mere department of the railroad itself."

When viewed in the light of the facts and the aforesaid rule, it becomes apparent that appellee and its affiliated distributing companies were engaged in an integrated but single business enterprise of producing, purchasing, transporting, delivering and selling natural gas for domestic or other use to the ultimate consumer. This was accomplished by combination of property and effort, and through ownership of more than 99% of the capital stock of appellee and all affiliated distributing companies by the holding corporation. All corporations are under the common management of the holding corporation, for which service it is paid management fees. The Texas corporations and the holding corporation have officers and directors common to each, who actually manage, supervise and control the entire business enterprise through the intercorporate setup. By permitting or organizing such intercorporate setup, the Texas corporations have, considering their entire operations as a whole, created a single and integrated business enterprise, and with respect to the jurisdiction of the Commission, to regulate and control such business, and particularly for the purpose of fixing the rates for which it might sell gas to the public in Texas, the corporation must be regarded as being engaged in the single business enterprise of producing, purchasing, transporting, delivering, and selling natural gas to the ultimate consumer or user in Texas. The fact that separate corporate entities were formed which represent different departments of the integrated but single business enterprise, does not affect the question, because the court must look beyond the corporate form to the purpose of the unified organization, and to the officials who are identified with that purpose. To otherwise hold, and to permit the

Texas corporations to so dispose of their capital stock and to so form a separate entity of their own, and to surrender the management and control of their business to the holding corporation, which has no permit to do business in Texas, would enable them to defeat the jurisdiction of the Commission over them as Texas public utilities, for which purpose the State of Texas granted them life and the privilege of doing business.

The fact that appellee and the affiliated distributing companies may be engaged in the integrated but single business enterprise of producing, purchasing, transporting and selling natural gas to the ultimate consumer or burner tip user, is not of controlling importance on the commerce issue; because the Commission did not fix the burner tip rate, nor did it require the distributing companies to pay appellee not in excess of the 32¢ city gate rate, and to pass the 8¢ reduction on to the ultimate consumer or burner tip user.

Just why the Commission fixed the 32¢ city gate rate for gas without also requiring the distributing companies to pay not in excess of such rate, and to pass the 8¢ reduction on to the ultimate consumer or burner tip user, is not clear from the order or record. It is conceded that the business of distributing gas from the city gate to the burner tip user was intrastate commerce over which the Commission had jurisdiction; and that it could have, after a hearing at which the reasonableness of the City gate rate charged by appellee for gas was inquired into, required the various distributing companies to pay appellee at each city gate a rate not in excess of the 32¢ rate, even though the gas sold and delivered by appellee moved in interstate commerce to the city gate. Article 1119, R. S. 1925, authorizes cities and towns of over 2000 population to fix local rates for gas sold by a public utility. Texas-Louisiana Power Co. *v.* City of Farmersville (Com. App.), 67 S. W. (2d) 235. The Commission is authorized to originate rates for cities and towns of less than 2000 population; and Article 6053 authorizes it to fix city gate and other rates for natural gas for all cities and towns without regard to population. The order recited that there were then pending some 125 appeals from rates fixed by cities and towns under the provisions of Arti-

cles 1119 and 6058, and that there were also pending before the Commission numerous cases in which the rates to be reviewed or fixed necessarily involved the determination of the reasonableness of the city gate rate charged the distributing companies by appellee, as a step preliminary to the disposition of such appeals and cases, and in order to determine or fix reasonable local or burner tip rates therein. All of these cities and towns were given notice of the hearing before the Commission. It would seem from these recitations of facts and circumstances, that the Commission consolidated all the appeals and cases pending before it in which the determination of the city gate rate charged by appellee for gas was necessarily involved as a step preliminary to reviewing or fixing the local or burner tip rates for gas. The wisdom of the method of procedure adopted cannot be successfully attacked. A separate hearing in the case of each city or town would have presented an insurmountable task; and if the expenses of this hearing are a criterion, no city or town could bear such expense. Separate hearings would not afford appellee any relief to which it is not entitled to receive here. Nor is it "essential that the Commission dispose of the matter before it in a single order, but it may in a proper case make a preliminary disposition of the matter, and reserve for further consideration, and dispose of by subsequent order, other questions or issues involved in the main issue without further notice or hearing." Houston Chamber of Commerce *v.* R. R. Com., 19 S. W. (2d) 586, affirmed 78 S. W. (2d) 591; Magnolia Pet. Co. *v.* Edgar, 62 S. W. (2d) 359 (writ ref.). Moreover, all parties have by court proceedings and otherwise treated the order as a final order fixing the 32¢ city gate rate. Certainly appellee has so treated the order, and if declared valid herein, appellee has no further interest in any order the Commission may make with regard to requiring the various distributing companies to pay not in excess of the 32¢ city gate rate, and to pass the 8¢ reduction on to the ultimate consumer or burner tip user. Furthermore, in its department of the intercorporate setup and affiliation appellee was a gas pipe line utility, engaged in the integrated business of producing, purchasing, transporting by

pipe line, and selling natural gas to the distributing companies at the city gates of some 300 cities and towns in Texas and Oklahoma. Appellee's charter and the books kept under the direction of the auditor of the intercorporate business setup established that it was so engaged. On the hearing before the Commission, all parties proceeded upon the theory that appellee was so engaged. It had contracts with the affiliated as well as the two independent distributing companies for the 40¢ city gate rate uniformly charged throughout the State of Texas by appellee. The Texas statutes authorize the Commission to fix reasonable city gate as well as local or burner tip rates for gas, and appellee states in its brief that "the Railroad Commission of Texas has power and authority to fix and prescribe the charges which defendant may make for gas produced or purchased by it and moving throughout its entire transit, up to the point of delivery at the city gates, wholly within the State of Texas, subject to defendant's right under the 14th Amendment of the Constitution of the United States, and the Bill of Rights of the Texas Constitution; and it has power and authority to determine the rates and charges to be received for the sale of gas to domestic customers in towns and cities in Texas (i. e. local rates), even though a part of the gas so sold has moved continuously in interstate commerce from the points of origin to the points of delivery at the city gates, subject to a similar qualification. But it may not regulate the gate rate to be charged by defendant for the sale of interstate gas." In view of these facts, admissions and proceedings, we will consider the rate order in question as a final appealable order, and pass to a further consideration of the interstate commerce issue.

Whether the conduct of appellee, in constructing and transporting by its private pipe line gas from the Texas Panhandle field through Oklahoma and back into Texas, where it is intended at all times to be delivered, sold and used, constitutes a fraudulent attempt to make such gas move in interstate commerce, and thereby deprive the Commission of the power to regulate the price for which it may be sold, does not appear to be material, because such transportation of the gas is not interstate commerce as a

matter of fact. Except for the right to authorize the construction of the pipe line within its boundary, the State of Oklahoma has no concern whatever with the transaction. Only one town, Hollis, in Oklahoma, is served by the pipe line. It could have been as well served by a direct pipe line from Texas to it, and such service is in no manner affected by the rate order in suit. The mere fact that such town is served with gas delivered from the pipe line does not stop, hinder, affect, or in any manner interrupt or interfere with the continuous flow of the gas from Texas through Oklahoma and back into Texas, where it is intended at all times to be delivered, sold and used.

In 1 Supreme Court Law, 347, the following rule is stated:

> "Interstate commerce is a practical conception drawn from the course of business upon a broad consideration of the substance of the whole transaction. Substance and not form controls. The actual fact, not technical considerations, governs."

The text cites many cases supporting the rule, holding in substance that what is or is not interstate commerce is to be determined upon broad consideration of the substance of the whole transaction. See Federal Trade Com. *v.* Pacific, etc. Ass'n, 273 U. S. 52, 71 L. Ed. 534; Eureka Pipeline Co. *v.* Hallanan, 257 U. S. 265, 66 L. Ed. 227; Swift & Co *v.* United States, 196 U. S. 375, 398, 49 L. Ed. 518; Dozier *v.* State, 218 U. S. 124, 54 L. Ed. 965, 28 L. R. A. (N. S.) 264.

Cases cited by appellee and many others hold that gas produced in one state and transported by pipe line to another state for sale and use is interstate commerce. 1 Supreme Court Law, 367. But no case is cited and none is found by us which would support a holding that the transportation by its private pipe line of gas produced or purchased by appellee in Texas through a corner of Oklahoma and back into Texas, uninterrupted, and with the intention at all times that such gas would be delivered, sold and used in Texas, is interstate commerce. Appellee is a Texas public gas utility corporation. Its primary duty is to serve

Texas citizens with gas produced from Texas soil. Its corporate life and being was granted in consideration of these premises. With this in view, but one practical conception can be drawn from the whole transaction involved, that is, the gas produced in Texas and intended to be delivered, sold and used in Texas is intrastate commerce. The mere fact that appellee has selected a route through Oklahoma as an aid to the transaction of its Texas business can not work a change in the nature of the business, nor does it affect the character of the business. The transportation of gas through Oklahoma is merely a method of delivery and is a negligible circumstance in determining the interstate commerce issue. Heyman *v.* Hays, 236 U. S. 178, 59 L. Ed. 527.

If, however, the delivery of the gas by appellee from Texas through Oklahoma and back into Texas, intended at all times for Texas consumption, be regarded as interstate commerce, such transaction only affects transportation of the gas and as to which only appellee and the Texas consumers are interested. The Interstate Commerce Act, as now amended, expressly excepts from the jurisdiction of the Interstate Commerce Commission the regulation of interstate transportation of "natural or artificial gas by pipe line, or partly by pipe line and partly by railroad and by water." U. S. C. A., Title 49, chap. 1, Sec. 1, subd. (1)(b). And since the regulation of the transportation of gas is expressly excluded from the scope of the interstate commerce statute, it is within the police power of the state to fix reasonable rates for which gas may be sold to its citizens, even though such rates may indirectly or incidentally affect the interstate transportation of such gas, or may so affect interstate commerce in the same. Simpson *v.* Shepard, 230 U. S. 352, 57 L. Ed. 1511, 48 L. R. A. (N. S.) 1151; West *v.* Kansas Natural Gas Co., 221 U. S. 229, 55 L. Ed. 716, 35 L. R. A. (N. S.) 1193; Pennsylvania Gas Co. *v.* Public Service Com., 252 U. S. 23, 64 L. Ed. 434; Manufacturers' Light & Heat Co. *v.* Ott (D. C.) 215 F. 940, 944, 945.

Neither the Texas statutes nor the rate order interfere in any manner with the transportation of gas from Texas

through Oklahoma and back into Texas. The order only attempts to regulate and fix the price for which such gas may be sold in Texas by appellee to its various distributing companies. Manifestly, this circuitous route of delivery of gas through Oklahoma can not and does not affect the exercise of the police power of Texas to make or fix reasonable rates for such gas sold to its citizens.

Appellee contends, however, that there can be no question but that the gas produced or purchased by it in Oklahoma and transported to and sold in Texas, is gas moving in interstate commerce up to the time it reaches the city gates of delivery; and that the fact that the amount of this gas is small does not affect its interstate commerce character, nor its interstate transportation. We do not sustain the contention.

The facts show that the gas produced or purchased by appellee in Oklahoma and transported by its pipe lines to Texas, does not move in interstate commerce, when it reaches the city gates of delivery. All gas coming from Oklahoma is run through extraction plants in Texas, where the heavier hydro-carbons and volatile gasoline are extracted, leaving the residue gas changed in its composition, and with its heating value lowered and changed. Large amounts of it are run through and stored in wells on the Miller farm near the extraction plant in Texas, continuously, and for use later as needed. The Oklahoma gas has no particular Texas city gate destination, but it is first transported to the extraction plants, and after its composition is changed, it is passed into the pipe line system of appellee, mixed and commingled with Texas gas, divided and redivided in the pipe line system until it is impossible to trace or identify it by volume at any city gate of delivery. At various points before delivery its pressure is reduced and the gas allowed to expand. The amount of Oklahoma gas as a whole is small and as divided and redivided before delivery to the various city gates, its amount is negligible in comparison with the amount of the Texas gas with which it is mixed or commingled.

Doubt has been expressed by several courts as to whether gas produced in several states and commingled in pipe

lines from which it is sold, is interstate commerce. This conclusion seems to have been reached on the "original package" doctrine, the courts holding that after the bulk of the imported gas is broken up for indiscriminate distribution to individual purchasers at retail sale, the interstate commerce is at an end. Contrary conclusions seem to have been reached where merely transmission for immediate or practically immediate use, direct from the seller to the consumer, is involved. But a different question arises where the gas transmitted from one state is stored and then distributed as its needs might afterwards develop; and where, as in this case, the composition of the gas is and must be changed by extracting hydrocarbons and volatile gasoline before it is ready for delivery and use by the consumer. As to such transmission of gas, the "original package" theory or doctrine is applicable and should be invoked, even though the transporting company, as did appellee and the affiliated distributing companies through stock ownership and intercorporate setup, actually sells the Oklahoma produced gas as changed to the ultimate consumers in Texas. These questions have been either passed upon or anticipated and discussed in the following cases. Pennsylvania Gas Co. *v.* Public Service Comm., 252 U. S. 23, 64 L. Ed. 434; Id., 225 N. Y. 397, 399, 122 N. E. 260; West *v.* Kansas Natural Gas Co., 221 U. S. 229, 55 L. Ed. 716, 35 L. R. A. (N.S.) 1193; Public Utilities Comm. *v.* Landon, 249 U. S. 236, 63 L. Ed. 577; Id., 249 U. S. 590, 63 L. Ed. 791; State *v.* Flannelly, 96 Kan. 372, 152 P. 22; West Virginia, etc. Co. *v.* Towers, 134 Md. 137, 106 A. 265.

In other cases it has been held that in the exercise of the police power of the state, the state commission has authority to fix the local burner tip rates, even though the gas moved in interstate commerce to the city gate, and particularly so where, as in the instant case, an affiliation exists between the transporting and the distributing companies. Thus the state commission may validly, by the indirect process of prescribing reasonable rates for local distributing companies, control and fix the city gate rate for gas moved in interstate commerce.

The Commission did not expressly require the distributing companies to pay not in excess of the 32¢ city gas rate,

but since this hearing was necessary as a preliminary step to the disposition of the appeals and cases pending, it was not essential that the Commission dispose of the matter before it in a single order; but it may, if the rate herein complained of be held not confiscatory or unreasonable and unjust, subsequently make its order requiring the distributing companies to pay not in excess of such rate, without further notice or hearing. Houston Chamber of Commerce *v.* R. R. Comm., *supra*. Manifestly, if the 32¢ rate is declared valid herein, appellee can have no further interest in any order the Commission may make with regard to requiring the various distributing companies to pay not in excess of such rate, and to pass the 8¢ reduction on to the ultimate consumer. Missouri *v.* Kansas Natural Gas Co., 265 U. S. 298, 68 L. Ed. 1027; Public Utilities Comm. *v.* Landon, *supra;* East Ohio Gas Co. *v.* Tax Com., 283 U. S. 465, 75 L. Ed. 1171; Pennsylvania Gas Co. *v.* Public Service Comm., *supra;* State Corp. Comm. *v.* Wichita Gas Co., 290 U. S. 561, 78 L. Ed. 500; Dayton P. & L. Co. *v.* Public Utilities Comm., 292 U. S. 290, 78 L. Ed. 1267; Gallatin Natural Gas Co. *v.* Public Service Comm., 79 Mont. 269, 256 P. 373.

Final decision, however, in most cases is rested upon the principle that the State may regulate interstate commerce of the character of natural gas in the absence of action by Congress. As hereinabove stated, the Interstate Commerce Act expressly excludes from the scope of the interstate commerce statute the transportation of natural gas. The amount of the rate or price to be charged for gas is primarily for the determination of the State in which the gas is consumed, and it is within the police power of the State to make or fix reasonable rates for gas furnished by a public utility to its citizens. Where the rates are reasonable and are fixed according to some uniform, fair and practical standard, they constitute no burden on interstate commerce. So, if the delivery of the gas by appellee from Texas through Oklahoma and back into Texas, intended at all times for Texas consumption; and if the production and transportation of the small amount of gas from Oklahoma to Texas, where it is sold, be regarded as interstate

commerce, still appellee's business is predominantly a Texas business; and it is within the police power of the State to fix reasonable rates for which gas may be sold to its citizens, even though such rates may indirectly or incidentally affect the interstate transportation of such gas, or may so affect interstate commerce in the same. Simpson *v.* Shepard, 230 U. S. 352, 57 L. Ed. 1511, 48 L. R. A. (N. S.) 1151, wherein it is held as follows:

> "Where the subject is peculiarly one of local concern, and from its nature belongs to the class with which the state appropriately deals in making reasonable provision for local needs, it cannot be regarded as left to the unreasonable will of individuals because Congress has not acted, although it may have such a relation to interstate commerce as to be within the reach of the federal power."

This doctrine has been carefully restated in the recent case of A. L. A. Schechter Poultry Corp. *v.* United States, 55 S. Ct. 837, 850, 79 L. Ed. 1570, 97 A. L. R. 947, as follows:

> "But where the effect of intrastate transactions upon interstate commerce is merely indirect, such transactions remain within the domain of state power. If the commerce clause were construed to reach all enterprises and transactions which could be said to have an indirect effect upon interstate commerce, the federal authority would embrace practically all the activities of the people; and the authority of the state over its domestic concerns would exist only by sufferance of the federal government. Indeed, on such a theory, even the development of the state's commercial facilities would be subject to federal control. As we said in Simpson *v.* Shepard (Minnesota Rate Case), 230 U. S. 352, 410, 33 S. Ct. 729, 745, 57 L. Ed. 1511, 48 L. R. A. (N. S.) 1151, Ann. Cas. 1916A, 18: 'In the intimacy of commercial relations, much that is done in the superintendence of local matters may have an indirect bearing upon interstate commerce. The development of local resources and the extension of local

facilities may have a very important effect upon communities less favored, and to an appreciable degree alter the course of trade. The freedom of local trade may stimulate interstate commerce, while restrictive measures within the police power of the state, enacted exclusively with respect to internal business, as distinguished from interstate traffic, may in their reflex or indirect influence diminish the latter and reduce the volume of articles transported into or out of the state.' See, also, Kidd *v.* Pearson, 128 U. S. 1, 21, 9 S. Ct. 6, 32 L. Ed. 346; Heisler *v.* Thomas Colliery Co., 260 U. S. 245, 259, 260, 43 S. Ct. 83, 67 L. Ed. 237."

It has also been held that "if it be assumed that interstate commerce will be incidentally affected, yet the regulation of the local charges of the Natural Gas Company as a public service corporation is within the police power of the State until the Congress sees fit to act." Manufacturers' Light & Heat Co. *v.* Ott, *supra*. And certainly the State's regulatory power is not denied where it does not interfere with or burden the free interstate flow of gas. Peoples Natural Gas Co. *v.* Public Service Com., 270 U. S. 550, 70 L. Ed. 726. The rate order in this suit does not in any manner interfere, restrain or burden the free transportation of gas between Texas and Oklahoma. Oklahoma gas may be freely transported to Texas and sold in the open market at the same reasonable rate fixed for Texas gas. We therefore conclude that, absent legislation by Congress, and since the Interstate Commerce Act as now amended, expressly excepted the regulation of transportation of "natural or artificial gas by pipe lines" from the jurisdiction of the Interstate Commerce Commission, the State Commission, in the exercise of the police power of the State to regulate and control public gas utilities, had the power to fix reasonable rates for gas delivered by appellee to distributing companies at the city gate, although interstate commerce may be indirectly or incidentally affected thereby.

We further conclude that since the amount of gas produced or purchased by appellee in Oklahoma and transported to and sold in Texas, is negligible; and, if interstate

commerce, the 32¢ rate fixed by the Commission in no manner interfered with, impeded, or burdened the flow of gas from Oklahoma, but such gas may be sold in competition with Texas gas and at the same reasonable price fixed by the Commission.

Freedom of Contract Issue.

The contracts of appellee with the distributing companies for the 40¢ city gate rate were made in the light of the Constitution and laws, and of the jurisdiction of the Commission to regulate such rates. The order changing such rate is therefore not violative of the freedom of contract, or impairment of obligation clauses of either the State or Federal Constitutions. (Const. Tex. art. 1, Secs. 16, 19; Const. U. S. art. 1, Sec. 10, cl. 1; Amend. 14).

The right of the State to regulate the rates and practices of a public utility is referable to the police power of the State, and is a legislative function which cannot be alienated or contracted away by the State or any agency or political subdivision of the State. The Constitution and laws of a state are a part and parcel of the terms of the corporate franchise, and the right of the state in the exercise of its police power to change franchise or contract rates in the protection of the inalienable rights and general welfare of its citizens is settled. Munn *v.* Illinois, 94 U. S. 113, 24 L. Ed. 77; Milwaukee Electric Ry., etc., Co. *v.* R. R. Com., 153 Wis. 592, 142 N. W. 491, L. R. A. 1915F, 744, Ann. Cas. 1915A, 911, affirmed in Id., 238 U. S. 174, 35 S. Ct. 820, 59 L. Ed. 1254; State *v.* Public Serv. Comm., 275 Mo. 201, 204 S. W. 497. The one exception to the rule is with regard to ordinances or contracts fixing rates for a limited period of time. Southern Iowa Electric Co. *v.* Chariton, 255 U. S. 539, 41 S. Ct. 400, 65 L. Ed. 764. Appellee's contracts are all for long periods of time, and do not come within the exception. And where, as in the instant case, there is an intimate alliance between the buyer and seller, and they are not dealing at arm's length because of intercorporate affiliation and transactions, the prices they fix are of no concern to the public, unless they are not within the bonds of reason. Houston *v.* Southwestern Bell Tel. Co., 259 U. S. 318, 323,

42 S. Ct. 486, 66 L. Ed. 961; Missouri ex rel. Southwestern Bell Tel. Co. *v.* Public Service Com., 262 U. S. 276, 288, 43 S. Ct. 544, 67 L. Ed. 981, 31 A. L. R. 807; United Fuel Gas Co. *v.* Railroad Com. of Kentucky, 278 U. S. 300, 320, 49 S. Ct. 150, 156, 73 L. Ed. 390, citing and quoting from Chicago & Grand Trunk Railway *v.* Wellman, 143 U. S. 339, 345, 12 S. Ct. 400, 36 L. Ed. 176, with approval; Smith *v.* Illinois Bell Tel. Co., 282 U. S. 133, 51 S. Ct. 65, 75 L. Ed. 255; Western Distributing Co. *v.* Public Service Comm. of Kansas, 285 U. S. 119, 52 S. Ct. 283, 76 L. Ed. 655; Dayton Power & Light Co. *v.* Public Utility Comm., 292 U. S. 290, 54 S. Ct. 647, 650, 78 L. Ed. 1267.

Confiscation of Property.

The constitutionality of a rate depends upon whether it will yield a fair return for the present and immediate future, on the value of the property used in the public service. In absence of an actual test under a new rate, the question of it will afford a reasonable return is one of fact. The burden rests heavily upon one seeking to set aside a state-made rate to plead and prove the invalidating facts. Ætna Ins. Co. *v.* Hyde, 275 U. S. 440, 48 S. Ct. 174, 72 L. Ed. 357, Beaumont, S. L. & W. Ry. Co. *v.* United States, 282 U. S. 74, 51 S. Ct. 1, 75 L. Ed. 221; Brush Electric Co. *v.* Galveston, 262 U. S. 443, 43 S. Ct. 606, 47 L. Ed. 1076. Appellee failed as a matter of law to plead and prove any invalidating fact as to the rate in suit; to which question we now pass.

Legal Sufficiency of Evidence to Show Rate Confiscatory or Unreasonable and Unjust.

The remaining question concerns the legal sufficiency of the evidence adduced by appellee to show that the 32¢ city gate rate was confiscatory and unreasonable and unjust. The rate was alleged to be so because it would not afford a reasonable return on the fair value of the property used in the public service of delivering gas to the various city gates, and amounted to taking the property without just compensation or due process of law, in violation of the 14th amendment to the Federal Constitution. When viewed in the light of the presumption in favor of the validity of the rate order,

and the quantum and character of the evidence required to overcome such presumption, the evidence adduced by appellee was clearly insufficient to show the rate confiscatory or unreasonable and unjust on the ground alleged.

The rate fixed by the Commission is presumed to be valid, reasonable and just until it is declared otherwise by a court of competent jurisdiction. R. R. Com. *v.* Uvalde Construction Co. (Tex. Civ. App.) 49 S. W. (2d) 1113. In order to overcome this presumption in favor of the validity of the rate on the constitutional ground of confiscation, the burden of proof rests heavily upon appellee. Dayton P. & L. Co. *v.* Pub. Utilities Comm., 292 U. S. 290, 54 S. Ct. 647, 78 L. Ed. 1267. And in order to set aside the rate as being unreasonable and unjust, Article 6059 requires that appellee show by "clear and satisfactory evidence that such rate is unreasonable and unjust as to it." A controversy immediately arises as to the proper interpretation to be given these rules and statutory requirements as to the burden and quantum of proof. The Commission contends that the rate must be sustained against the attack that it is confiscatory and unreasonable and unjust, because it does not allow a reasonable return on the fair value of the property, when it is shown to be based upon substantial evidence adduced before the Commission, and that only the evidence adduced before the Commission on the rate hearing may be considered on appeal to the court. On the other hand, appellee contends that the hearing on appeal to the court of such issues is de novo, and that "due process of law requires submission to a judicial tribunal for determination upon its own independent judgment as to both law and facts according to the settled rules governing judicial action and decision." Otis Elevator Co. *v.* Indus. Comm. 302 Ill. 90, 134 N. E. 19, 21; Ohio Valley Water Co. *v.* Ben Avon Borough, 253 U. S. 287, 40 S. Ct. 527, 64 L. Ed. 908; Reagan *v.* Farmers' Loan & Trust Co., 154 U. S. 363, 14 S. Ct. 1047, 38 L. Ed. 1014. As regards the rate making power of the Commission, the Texas courts have adopted this wider scope of review. R. R. Comm. *v.* H. & T. C. R. R. Co., 90 Tex. 340, 352, 38 S. W. 750; R. R. Comm. *v.* Weld & Neville, 96 Tex. 394, 403, 73 S. W. 529; Gulf, C. & S. F. Ry. Co. *v.* R. R. Com., 102 Tex. 338,

113 S. W. 741, 116 S. W. 795; R. R. Com. *v.* San Antonio Compress Co. (Tex. Civ. App.) 264 S. W. 214 (writ ref. Id., 114 Tex. 582, 278 S. W. 1115); Houston Chamber of Commerce *v.* R. R. Comm. (Tex. Civ. App.) 19 S. W. (2d) 583, affirmed (Tex. Com. App.), 78 S. W. (2d) 591, and Missouri-Kansas & T. Ry. Co. *v.* R. R. Com. (Tex. Civ. App.) 3 S. W. (2d) 489, 494, affirmed Producers' Ref. Co. *v.* Missouri, K. & T. R. Co. (Tex. Com. App.) 13 S. W. (2d) 679, wherein this court said:

> "Rate making is essentially a legislative function, and operates prospectively. Railroad Com. v. Weld & Neville, above; Prentis v. Atlantic Coast Line Co., 211 U. S. (210), 226, 29 S. Ct. 67, 53 L. Ed. (150), 158, 159, and authorities there cited. And the same is true of many rules and regulations within the delegated powers of the commission. Rate making has been delegated to the Railroad Commission alone, and its acts in that regard have the force and effect of statutes, and are subject to review to the extent only that statutes of the same import are so subject, with the additional power which articles 6657 and 6658 confer upon the courts to determine whether a rate, etc. is unreasonable or unjust to the party complaining."

The case of Crowell *v.* Benson, 285 U. S. 22, 76 L. Ed. 598, in determining the scope of review and whether new evidence will be heard on appeal from a state commission's rate order, held as follows:

> "In cases brought to enforce constitutional rights, the judicial power of the United States necessarily extends to the independent determination of all questions, both of fact and law, necessary to the performance of that supreme function.' The case of confiscation is illustrative, the ultimate conclusion almost invariably depending upon the decisions of questions of fact. This court has held the owner to be entitled to 'a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts. * * *.
>
> "Assuming that the Federal court may determine for itself the existence of these fundamental or juris-

> dictional facts, we come to the question—Upon what record is the determination to be made? There is no provision of the statute which seeks to confine the court in such a case to the record before the deputy commissioner or to the evidence which he has taken. * * *
>
> "We think that the essential independence of the exercise of the judicial power of the United States in the enforcement of constitutional rights requires that the Federal court should determine such an issue upon its own record and the facts elicited before it."

See, also, State Corp. Com. *v.* Wichita Gas Co., 290 U. S. 561, 54 S. Ct. 321, 78 L. Ed. 500; Lehigh Valley R. Co. *v.* Com'rs, 278 U. S. 24, 49 S. Ct. 69, 73 L. Ed. 161, 62 A. L. R. 895; Prendergast *v.* N. Y. Tel. Co., 262 U. S. 43, 43 S. Ct. 466, 67 L. Ed. 853.

As regards the statutory appeal authorized by Article 6059, to determine whether a rate order is unreasonable and unjust, it is manifest that the legislature intended for the trial on appeal to be de novo and upon new or additional evidence pertinent to the issue, because the complainant is required to show by "clear and satisfactory evidence that such rate is unreasonable and unjust as to it." Similar statutes regarding railroad rates have been so construed by the above cited Texas cases, and in other states. The scope of judicial appellate review of orders of administrative boards or commissions is usually controlled by legislative enactment. This may be either by a hearing de novo or it may mean merely the correction of non-permissible error. Freund on Administrative Powers over Persons and Property, 278. Statutes which authorize appeals from matters of purely administrative decision or discretion are usually construed to authorize only the correction of non-permissible error, or to favor the merely corrective scope of review. Illustrative of these matters is the question of issuing a license, or the granting of a permit, or determining whether a public necessity or convenience exists for bus or truck operation. In such cases the legislature does not vest in courts the administrative function of determining whether a license, permit, or certificate of convenience

or necessity should issue, but merely gives the courts authority to determine whether the action of the administrative board or commission is (a) beyond the power it could constitutionally exercise, or (b) beyond its statutory power, or (c) based upon substantial evidence.

As to such administrative matters the legal effect of the findings of fact by the administrative body approximates a question of law, and a finding without evidence is, of course, beyond the power of the administrative body. Nor will courts in such cases review conclusions of the administrative body based upon conflicting evidence; but will sustain its order if based upon substantial evidence. Such is the holding in the case of R. R. Comm. *v.* Shupee (Tex. Civ. App.) 57 S. W. (2d) 295, affirmed Id., 123 Tex. 521, 73 S. W. (2d) 505, and R. R. Comm. *v.* Lamb (Tex. Civ. App.) 81 S. W. (2d) 161. But the questions of whether a rate is confiscatory or unreasonable and unjust have been held to be legal or justiciable questions of fact, and as to which the wider scope of judicial appellate review seems to have been adopted by the legislature and courts of this state. The limited scope of judicial review of rates fixed by an administrative commission was first enforced (Peik *v.* Chicago, etc. Ry. Co., 94 U. S. 164, 178, 24 L. Ed. 97) by the courts; but was soon abandoned, and through a process of trial and argument of several cases, the present rule that the 14th Amendment to the Constitution protects the property of citizens from confiscation by an act of the legislature or by a commission to which legislative regulatory power has been delegated, was developed. State *ex rel.* Southwestern Bell Tel. Co. *v.* Pub. Serv. Com. (Mo. Sup.) 233 S. W. 425, 430.

But whether the scope of judicial review is a hearing de novo or the correction of non-permissible error, the appeal is still merely corrective. The question is not whether the court, if the order were originally before it, would make the same order as was made by the Commission, but only whether the commission has acted reasonably upon sufficient evidence, and whether any substantial right of the complaining party has been infringed. In determining the sufficiency of the evidence under the wider scope of judicial review, the question is not whether there is a scin-

tilla of evidence to support the order, but whether the order is fairly and substantially supported by the evidence, when viewed in the light of the presumption in favor of the order, and the quantum and character of the evidence required to overcome such presumption. Particularly is this so with regard to making rates or division of rates, which are legislative and not judicial in character, and necessarily imply a range of legislative discretion, which the courts must recognize, and with which they cannot interfere except where constitutional or statutory rights are violated. The reason for the court appeal being corrective only is well stated in the Bell Telephone case, *supra*, as follows:

> "The statutes declaring rates fixed by the Commission to be prima facie reasonable until that presumption is removed by one seeking their annulment are but a proper recognition of the power and purpose of the Commission, without which its acts would be mere empty declarations, whose effective operation would, in each instance, have to await judicial approval. Such a conception of the nature and powers of the Commission is wholly unauthorized. Organized, as the Statute creating the Commission clearly declares, for the purpose of supervising and regulating public service corporations, the courts, in reviewing its actions, proceed upon the assumption that the experience of the members of the Commission has especially fitted them for dealing with questions concerning the powers and activities of such corporations; and, despite the fact that the entire evidence will be reviewed, much consideration is to be given to the findings of the Commission, which if reasonable, and neither arbitrary nor capricious, will be deferred to. New York *ex rel.* N. Y. & Queens County Gas Co. *v.* McCall, 245 U. S. (345), loc. cit. 347, 38 S. Ct. 122, 62 L. Ed. 337."

In the case of R. R. Commission *v.* Galveston C. of C., 105 Tex. 101, 145 S. W. 573, 580, which construed the similar statutes authorizing appeals from railroad rates fixed by the Commission, and the statutory requirement that complainant show "by clear and satisfactory evidence that the

rates are unreasonable and unjust," the scope of judicial appellate review was held to be as follows:

> "The foregoing statute so guards the Commission from improper interference that the courts must regard its actions, when within the limits of its delegated powers, as being the result of a purpose to do justice between all parties, and as having resulted in just and correct action until it be shown by clear and satisfactory evidence to be otherwise. R. R. Commission *v.* Weld & Neville, 96 Tex. (394), 409, 73 S. W. 529. The language, 'clear and satisfactory evidence,' limits the power of courts in setting aside rates, etc., to cases in which it may be established by evidence which leaves no reasonable doubt in the judicial mind that the rate or rule is unjust and unreasonable. Willis *v.* Chowning, 90 Tex. 617, 40 S. W. 395, 59 Am. St. Rep. 842. It is true that this attributes to the work of the Commission a high degree of verity, but it is the plain language of the law, and is no doubt a wise provision.
>
> "It is not within the language nor the spirit of the law which authorizes the courts to review the action of the Railroad Commission that any court should investigate the methods adopted by the Commission in fixing its rates nor the motives or purposes which prompted such action. The result and its effect upon the rights of railroads and shippers mark the limit of judicial inquiry."

The rules and statutory requirements are general in nature and their applicability necessarily depends upon the facts in each case. No rule can be laid down as to rates which will apply uniformly to all sorts of utilities. In determining whether a rate is confiscatory or unreasonable and unjust because it may not in the future yield a proper return, the basis of calculation is the fair value of the property used in the public service. What may be a fair return for one may be inadequate for another, depending upon circumstances, competition or monopoly, public necessity, speculative and highly profitable enterprises, hazards, locality and risk. And where as in the instant case the evidence is conflicting and the conclusion to be drawn there-

from in respect of this or that item uncertain or speculative, the court should not interfere with gas rates in advance of any actual experience of the practical result of such new rates. Willcox *v.* Consolidated Gas Co., 212 U. S. 19, 29 S. Ct. 192, 53 L. Ed. 382, 48 L. R. A. (N. S.) 1134, 15 Ann. Cas. 1034; Brush Elec. Co. *v.* Galveston, 262 U. S. 443, 43 S. Ct. 606, 67 L. Ed. 1076; N. P. Ry. Co. *v.* North Dakota, 216 U. S. 579, 30 S. Ct. 423, 54 L. Ed. 624; Cedar Rapids Gas Light Co. *v.* Cedar Rapids, 223 U. S. 655, 32 S. Ct. 389, 56 L. Ed. 594; City of Louisville *v.* Telephone Co., 225 U. S. 430, 32 S. Ct. 741, 56 L. Ed. 1151; City of Knoxville *v.* Knoxville Water Co., 212 U. S. 1, 29 S. Ct. 148, 53 L. Ed. 371. Especially is this true where our statutes and the rate order here complained of provide that "this proceeding shall be kept open for such orders as may be proper." Immediately upon the rate in question being fixed, appellee applied to the courts to restrain its enforcement before an actual test was had under the reduced rate.

On the hearing before the Commission as well as on appeal to the court, five primary factors were considered as essential to the correct determination of whether the rate was confiscatory or unreasonable and unjust because it did not allow a reasonable return on the fair value of the property of appellee used in the public service of delivering natural gas to the various city gates, as follows:

1. What was the present fair value of the property of appellee used in the public service?

2. What was a reasonable annual allowance for depreciation of such property?

3. What were the reasonably necessary operating expenses?

4. What were the reasonable operating revenues?

5. What was a reasonable rate of return on the property used?

The fair value of the property used by appellee in the public service was determined by deducting from the reproduction cost new the accrued depreciation of such property. Since appellee was engaged in the integrated business of

producing, purchasing, transporting and selling natural gas to the distributing companies at the city gates of some 300 cities and towns in Texas and Oklahoma, it became necessary to allocate or segregate the property used in Texas as well as that used conjointly in both states, in order to determine the fair value of the property used in the Texas public service, the annual depreciation thereof, and the Texas operating expenses and revenue. In making the segregation and proof of fair value of the property, both the Commission and appellee used calculations, estimates and opinions of expert accountants and engineers. However, different methods of segregation were adopted by the parties. The method of segregation adopted by the Commission provided for allocation to Texas operations, or to intrastate commerce the value of all property located within the physical boundary of Texas. The short section of pipe line from Texas Panhandle field across the corner of Oklahoma and back into Texas was also allocated to Texas operations. Gas sales adjustment was made wherein Texas or intrastate operations were charged with the net amount of Oklahoma produced gas for the six-year (1929-1934) accounting period adopted by the Commission. No charge against Oklahoma or interstate operations was made for the use of the transmission lines and for equipment within Texas; the effect of which was to give free transportation in Texas of all Oklahoma produced gas. Texas and Oklahoma expenses and revenues were allocated in general accord with the segregation of the physical properties. Under this method the fair value of the property undepreciated used in Texas public service was $40,256,862.39, according to the calculations and opinions of the Commission's experts. After deducting the operating expenses and annual depreciation there remained for the last two years of the accounting period, being the two lowest revenue years of the period, Texas net revenue which would yield a return of 6.74% and 6.76%, respectively. The method of segregation used by appellee was materially different. Under its method of segregation all of the gas produced or purchased by appellee in Texas Panhandle field and transported by its private pipe lines across the corner of Oklahoma and back into Texas for sale and use, and all Oklahoma produced

gas were allocated to interstate commerce. The allocation was made by a determination of the specific gravity of the Oklahoma and Texas Panhandle gas on the one hand, and West Texas gas with which it was commingled in pipe lines on the other hand. It seems that the Oklahoma and Panhandle gas had about the same specific gravity. Appellee claimed that by determining the specific gravity of the gas in any particular pipe line, the percentage of Oklahoma-Texas Panhandle gas could be determined and allocated to that line. Appellee allocated operating expenses and revenue between the two states upon substantially the same basis as used for the property. An expert employed by appellee found the fair value of property used in Texas public service, based upon reproduction cost new, less depreciation, to be $38,350,882.32. He excluded from this calculation all property and equipment used in handling the Texas Panhandle field gas. If he had allocated such property to Texas and considered the fair value of the property as undepreciated, there would have been very little difference between his finding of fair value and that found by the Commission's experts. However, in all their elaborate calculations, estimates and opinions, the experts employed by the appellee allocated the Texas Panhandle gas to interstate commerce. We have held that this gas did not move in interstate commerce, and it necessarily follows that the testimony of the experts based upon the erroneous assumption that such gas did move in interstate commerce proved nothing material to this case. Appellee offered no other proof upon a correct segregation or allocation of the property, and the trial court erred in refusing the Commission's motion for an instructed verdict and for judgment declaring the rate order appealed from to be valid in every respect. The burden was upon appellee to show by clear and satisfactory evidence a proper segregation of interstate and intrastate properties and business, and to show the value of the property employed in intrastate business or commerce and the compensation it would receive under the rate complained of upon such valuation. Having failed to make a proper segregation of interstate and intrastate properties, appellee did not adduce the quantum and character of proof necessary to establish the invalidity of the rate as being con-

fiscatory, or unreasonable and unjust. Simpson *v.* Shepard, 230 U. S. 352, 33 S. Ct. 729, 57 L. Ed. 1511, 48 L. R. A. (N. S.) 1151, Ann. Cas. 1916A, 18; Allen *v.* St. Louis, I. & M. S. R. Co., 230 U. S. 553, 33 S. Ct. 1030, 57 L. Ed. 1625; Smith *v.* Illinois Bell Tel. Co., 282 U. S. 133, 51 S. Ct. 65, 75 L. Ed. 255.

Clearly the difference in theory as to whether the gas produced or purchased by appellee in the Texas Panhandle field and transported by its private pipe line across a corner of Oklahoma and back into Texas, where it was intended at all times to be sold and used, accounts for most of the important difference with respect to the fair value of the property used in Texas public service, the annual depreciation thereof, and particularly as to the operating expenses and revenues. For instance, the Texas Panhandle gas cost appellee 2¢ per thousand cubic feet at the well; whereas, the gas from all other sources or fields cost from 6 to 10¢ per thousand cubic feet. The advantage in favor of appellee in excluding this gas from intrastate commerce is apparent. The cost of the 2¢ gas would add only about $125,000 annually to Texas operating expenses, according to appellee's Exhibit No. 46; whereas, according to the same exhibit, which shows the percentage of the total cost of gas transported from the Panhandle field and sold in Texas, the Texas revenue would have been increased for the 1929-1933 period more than $1,500,000 annually; and calculations show that if other proper operating expenses were included and charged against the Panhandle gas, still the profit in such gas was more than in other gas handled by appellee either in Oklahoma or Texas. Thus the double advantage to appellee in freezing this gas from intrastate commerce and from state regulation is shown.

The appraisals also differ as to various units of transmission construction costs, due in a large measure to the difference in theory of segregation. Where they relate to the same property the appraisals are in every way comparable. Appellee used actual cost experiences and arbitrarily added 20% as possible contingencies. The Commission allowed only actual cost experience, which were substantiated by the testimony of contractors engaged in excavation and general construction work. At most the evidence merely presented the difference of opinions of equally

well qualified experts. Manifestly this evidence in absence of actual experience under the rate, does not meet the quantum and character of proof necessary to set aside the rate order as being confiscatory or unreasonable and unjust as to appellee.

The greatest difference between the parties relates to a proper allowance for depreciation and amortization. Appellee estimated that for both Texas and Oklahoma properties, exclusive of gas leasehold depletions, the annual requirement for depreciation and amortization was $3,465,-123.36. The Commission estimated that appellee should be allowed for annual depreciation and amortization of its Texas properties, exclusive of leaseholds, the sum of $831,-946.08. The actual experience of the appellee for the seven-year period as shown by its books, is as follows:

"Jan. 1, 1927, to Dec. 31, 1933, inclusive

Jan. 1st	Balance.	Accrual.	Net Charges.
1927	$8,294,762.08	$1,280,856.10	$245,097.73
1928	9,330,520.45	1,198,192.50	260,768.59
1929	10,267,944.36	1,190,062.06	450,335.00
1930	11,007,671.42	580,022.80	464,875.93
1931	11,122,818.29	1,841,779.61	720,014.28
1932	12,244,583.68	1,841,508.16	(Credit 62,725.18
1933	14,148,817.02	1,882,333.41	335,736.55
1934	15,695,413.88	Total....	$2,414,102.90"

Thus it is shown that the depreciation allowance of appellee's experts is speculative, at war with the actual experience, and plainly excessive. Against $2,414,102.90 for the seven-year period as evidenced by appellee's books, its experts estimate annual depreciation and amortization at approximately $1,000,000.00 per year more. With respect to such proof it was held in the case of Lindheimer *v.* Ill. Bell Tel. Co., 292 U. S. 151, 54 S. Ct. 658, 668, 78 L. Ed. 1182, that:

> "The company has had abundant opportunity to establish its contentions. In seeking to do so the company has submitted elaborate estimates and computations, but these have overshot the mark. Proving too much, they fail of the intended effect. • • •
>
> "Elaborate calculations which are at war with realities are of no avail."

The Commission adopted the sinking fund method for determining annual depreciation, which provides for an annual return on an undepreciated rate base; and which in addition to the annual depreciation of $831,946.08, also allowed 6% per annum on the accumulated depreciation reserve. The calculations and estimates of appellee applied to both Texas and Oklahoma properties, and since such calculations and estimates are so contrary to the experience of the company, they do not meet the quantum and character of proof required with respect to judicial appellate review of utility rates fixed by an administrative commission or board. Dayton P. & L. Co. *v.* Pub. Utilities Comm., *supra.*

With respect to operating expenses, except as to a few controverted items, and with respect to revenues, there is no substantial difference in the testimony as to totals of both Texas and Oklahoma for the years of the accounting period. However, the same controversy arises as to a proper segregation of such expenses and revenues to each state. This difference has already been pointed out, and since appellee failed to make proper segregation of the expenses and revenues, it failed to prove its case.

Many items of operating expense are so contrary to the actual experiences of appellee, or are so large as to be excessive on their face. A few of these will be adverted to as showing that in proving too much appellee's experts proved nothing.

Federal Taxes.

An item of between three and four hundred thousand dollars a year is set aside by the experts as federal income and other taxes. The company has never paid an income tax, and its liability therefor is now in litigation. The only testimony in the record with regard to the amount that should be paid for taxes by appellee in its department of the corporate hook-up was around $50,000 per annum. The testimony indicates that the Lone Star Gas Corporation, the holding company, has paid all of the income taxes for all of its affiliated companies; but if it be assumed that such payment is chargeable back to appellee company, a proper amount would not be more than $50,000 per year, instead

of the three or four hundred thousand dollars charged against it by the experts. Galveston Electric Co. *v.* Galveston, 258 U. S. 388, 42 S. Ct. 351, 66 L. Ed. 678.

Management Fees.

The evidence shows that the holding corporation has charged appellee management fees ranging from $78,000 to around $100,000 per year. These fees appellee claims were earned by four persons, Crawford, Mitchell, Gregory and Simpson. They are directors of one or the other corporations constituting the corporate set-up above referred to. Simpson seems to have rendered service as a purchaser of pipes for appellee. The item of pipes was the greatest of appellee's expenses. The evidence shows that if Simpson rendered any service in purchasing pipes at a discount, that no such discount would be any longer allowed, and that appellee would have to pay the quoted prices like anyone else. Manifestly this service is not worth anything in the future. Besides, he rendered the services prior to 1929, when the management fee was originated, and no compensation was required before that time. Other management fees were charged, as legal fees, accounting fees, and engineering and supervision fees. Appellee was organized in 1909, with a capital stock of $2,500,000, half of which was paid for with gas leases owned by the incorporators. Since then its capital stock has been increased to $12,500,000. It borrowed on its unsecured note or open account $17,600,000 from the holding corporation, which debt with others amounting to $19,000,000, have been gradually reduced. The holding corporation borrowed this money from one-half to two per cent less than it charged appellee. This ought to be sufficient management fees, if any should be demanded by the holding corporation. The holding corporation has been paid fair to large dividends annually on the stock of appellee owned by it. In addition, some of the holding company officers are paid salaries by appellee and the affiliated distributing companies. The proof as to the reasonableness of the management fee was not clear and satisfactory, as required to be under the aforementioned rule.

New Business Expenses.

These advertising or new business expenses vary from $81,000 to $126,000 per annum. Appellee does business with the affiliated corporations. Besides sale of the industrial gas, the affiliated corporations sell to the domestic and local burner tip consumers. Appellee proved only a small amount of advertising, nothing in proportion to the charges made by the experts in their account. Except for a few items, it made no showing how much advertising it did for the affiliated distributing companies; and certainly this $100,000 annual expense for advertising is not supported by the quantum and character of evidence required.

Cancelled and Surrendered Leases.

The undisputed evidence shows that appellee has gas reserves which are adequate for forty years to come. It has gas reserves in the largest gas fields in the world. Beginning in 1929, appellee began to charge off around $200,000 per annum for cancelled and surrendered leases. In view of its admitted large gas reserves, which will last for forty years, and in view of the fact that it is a matter of judicial knowledge that gas by the multiplied millions in cubic feet is being wasted daily because of the lack of a market, we think these large charges are unjustified. The Commission allowed the company for its gas produced from company owned wells the full prevailing price. They eliminated production expenses, drilling and tool expenses, dry holes, and cancelled and surrendered leases, because the method adopted of allowing the full prevailing field price concurrently paid to other gas owners necessarily eliminated such items. The owners of other gas wells bear all of these expenses, and it would seem that the price paid other owners includes all of these items of expense. West Ohio Gas Co. *v.* Public Utilities Comm., 128 Ohio St. 301, 191 N. E. 105. At any event, if appellee was entitled to some charge for leasehold depletions, the amount claimed was clearly too large and excessive. The burden was upon appellee to show that the charge was reasonable.

Regulatory Commission and General Expenses.

The experts employed by appellee charged in excess of $400,000 per annum for regulatory commission and general expenses. The proof did not show the reasonableness of any item of such expense. There was some character of litigation in Oklahoma and this present litigation. If the entire expense should be spread over a period of years since 1909, when the appellee began to do business, it would amount to some $16,000 per year. A witness for appellee testified that such annual amount would be reasonable. It is, therefore, manifest that $50,000 per year or better for such expenses is too much. This defendant began business in 1909, with a comparatively small capital stock. It has now a capital stock of $12,500,000, which is fully paid up. It owes approximately $17,600,000; it has properties in Oklahoma and Texas of the aggregate value of $75,000.000. Allocated to Texas public service is property valued at $40,000,000. Appellee offered evidence covering only about 3½ years next preceding the fixing of the rate as to its operating expenses. These calculations covered the depression years, which, of course, are the worst in its history; and even at that the last year shows an upward trend in its business. It is not shown to have lost money at any time, or to have failed to earn a fair return upon the property allocated to Texas, not even for the year 1933, which was the most abnormal one from the standpoint of temperature and financial depression. Its experts testified that its property is almost 85% perfect. From the very beginning appellee has been favored, enjoying a clear monopoly with all the rights of eminent domain. There is nothing in the history of appellee's business experience which would justify the exorbitant and large account sought to be charged in this item of expense.

Going Value.

In arriving at its rate base appellee included an item of more than $7,000,000 as "going value." Appellee has not experienced any losses on account of inception costs, which are usually included in going value. With the exception of

all items, inception costs of all kinds have been in reproduction cost new calculations. Appellee's was valued as an assembled and going business. ness has been profitable, and all inception costs doubt been long since paid out of rates heretofore and collected. The reproduction cost new value, mined in the instant case, allows for all overhead which, together with the reasonable operating ex- lowed, fully compensate appellee for all develop- ts which have been incurred, and are ample to ms entering into and forming a part of what is to as "going concern value." The following au- show clearly the impropriety of allowing going value under the facts of the instant case. Los Gas & Electric Corp. *v.* R. R. Com., 289 U. S. 287, 637, 77 L. Ed. 1180; Columbus Gas & Fuel Co. *v.* Com., 292 U. S. 398, 54 S. Ct. 763, 78 L. Ed. 1327, R. 1403; Dayton Power & Light Co. *v.* Utility Com., 290, 54 S. Ct. 647, 78 L. Ed. 1267; Galveston Elec- . Galveston, 258 U. S. 388, 42 S. Ct. 351, 66 L. Ed. D. C.) 272 F. 147.

Rate of Return.

he contention of appellee that the jury may have at a 6% rate of return was confiscatory or un- e and unjust. The issue of confiscation was not l to the jury, and we are clear in the view that the adduced by appellee did not raise a jury question ther a 6% rate of return was either confiscatory onable and unjust. The Commission found that of return on the fair value of the property used ublic service after allowing for all reason- ating expenses and for depreciation and amor- was sufficient. The burden was heavily upon o show by clear and satisfactory evidence that of return was confiscatory or unreasonable and o meet this test appellee was required to "estab- idence which leaves no reasonable doubt in the ind that the rate is unjust and unreasonable." m. *v.* Galveston C. of C., *supra*. This appellee

did not do. It offered the testimony of an interested witness and the testimony of experts employed by it to the effect that in their opinion an 8% or 10% rate of return would be reasonable. A disinterested expert testified that under present business conditions a 6% rate of return was entirely fair and reasonable. This evidence merely presented the difference of opinion of experts, and manifestly their opinion or opinions cannot be substituted for the finding of the commission that a 6% rate of return was fair and reasonable, which finding was based upon substantial evidence. In fact, six per cent per annum is the legal or statutory rate of interest in this State, and appellee offered no evidence which even tended to show that a 6% rate of return would confiscate its property, or was unreasonable or unjust. And since the rate order was calculated upon the fair value of the property used in the public service, after allowing very reasonable operating expenses and depreciation and amortization allowances, no reason exists why the 6% rate of return should be declared confiscatory; but to the contrary, it should be held to allow a fair and reasonable rate of return on the property dedicated to the public service by appellee.

A 6% rate of return has been held not confiscatory in the following cases: Willcox *v.* Consolidated Gas Co., 212 U. S. 19, 48, 50, 29 S. Ct. 192, 53 L. Ed. 382, 48 A. L. R. (N. S.) 1134, 15 Ann. Cas. 1034; Cedar Rapids Gas Light Co. *v.* Cedar Rapids, 223 U. S. 655, 670, 32 S. Ct. 389, 56 L. Ed. 594; Des Moines Gas Co. *v.* Des Moines, 238 U. S. 153, 172, 35 S. Ct. 811, 59 L. Ed. 1244. See, also, Stanislaus County *v.* San Joaquin & King's River C. & I. Co., 192 U. S. 201, 216, 24 S. Ct. 241, 48 L. Ed. 406; West Ohio Gas Co. *v.* Public Utilities Com., 128 Ohio St. 301, 191 N. E. 105, 115; State *ex rel.* Capital City Water Co. *v.* Public Service Comm. of Mssiouri, 298 Mo. 524, 252 S. W. 446, 454-459.

We are also clear in the view that where a state commission fixes a utility rate so as to allow a 6% rate of return on the property used in the public service, the courts will not, prior to a fair test of such rate, declare same void, unless the evidence establishes that it is confiscatory or

invalid as a matter of law. Denver Union Stock Yard Co. *v.* United States (D. C.) 57 F. (2d) 735, 752, 753; State *v.* Public Service Com., 298 Mo. 524, 252 S. W. 446, 458; Knoxville *v.* Water Co., 212 U. S. 1, 15, 29 S. Ct. 148, 53 L. Ed. 371; West Ohio Gas Co. *v.* Public Utilities Comm., 128 Ohio St. 301, 191 N. E. 105, 110, Cedar Rapids Gas Light Co. *v.* Cedar Rapids, 223 U. S. 655, 666, 670, 32 S. Ct. 389, 56 L. Ed. 594; Willcox *v.* Consolidated Gas Co., 212 U. S. 19, 51, 29 S. Ct. 192, 53 L. Ed. 382, 48 L. R. A. (N. S.) 1134, 15 Ann. Cas. 1034; Railroad Com. of Louisiana *v.* Cumberland Tel. & Tel. Co., 212 U. S. 414, 426, 29 S. Ct. 357, 53 L. Ed. 577.

The calculations, estimates and opinion of its experts show a studied effort on the part of appellee to charge large items as operating expenses and depreciation, at war with the actual experience of the company, and we find no proof which would authorize the trial court to submit any issue to the jury, but find that appellee wholly failed to meet the burden of proof placed upon it, and to show by clear and satisfactory evidence that the rate was confiscatory, unjust, and unreasonable as to it. Especially is this true in view of the rule that absence actual experience under the rate fixed, the courts will not disturb a rate where the evidence is so conflicting, and the conclusions to be drawn therefrom in respect to this or that item uncertain and speculative; and particularly is this true where, as in the instant case, if it be shown in actual experience that the rate would not afford a reasonable return and was confiscatory, appellee is free to make another application for relief before the Commission.

Judgment of the trial court declaring the rate to be unjust and unreasonable is reversed. The injunction granted by the trial court is dissolved, and the city gate rate of 32¢ fixed by the Commission is declared to be just, reasonable and valid in every particular.

M. B. Blair,
Associate Justice.

Judgment trial court reversed; Injunction Dissolved.
Filed July 10, 1935.

APPENDIX "B".

Opinion of Court of Civil Appeals on Motion for Rehearing.

(Reported 86 S. W. (2d) p. 506)

No. 8238.

Motion No. 8153.

THE STATE OF TEXAS *et al, Appellants,*

vs.

LONE STAR GAS COMPANY, *Appellee.*

ON APPELLEE'S MOTION FOR REHEARING.

On motion for a rehearing appellee makes the claim that the record does not sustain some of our findings of fact. No reference is made to the record in support of such claim. Most of the asserted discrepancies relate to the valuation of the property used in the public service, or to alleged necessary operating expenses. We held that as a matter of law appellee failed to establish by clear and satisfactory evidence the ultimate fact issue, to-wit: Whether the rate fixed by the Commission was so low as not to afford a reasonable return on the fair value of the property used in the Texas public service. Appellee was afforded a seven months hearing before the Commission and a three months trial on appeal to the court. It made no segregation as between its Texas and Oklahoma properties and operations; and did not prove the fair value of the property used in the Texas public service. The question of the value of such property determines the reasonableness of the rate and probably, in the ultimate analysis, adequacy of service and principles of financing. Valuation of such public service property is in the main a matter of estimate or opinion, and closely resembles discretion as regards the finding of value by an administrative commission. In any event, a scientific or statutory standard of absolute value is unattainable; and because of this uncertainty of value, except where the evidence clearly shows gross over or under valuation, or mistake, inequality or fraud in the appraisal,

the finding of value by an administrative commission is generally given finality. Especially is this the rule in absence of an actual test under the new rate. In addition to the authorities cited in the original opinion, see the following: People *v.* Board of Assessors, 39 N. Y. 81; Taylor *v.* L. & N. R. Co. (C. C. A.) 88 F. 350; Chicago *v.* Burtice, 24 Ill. 489; State Railroad Tax Cases, 92 U. S. 575, 23 L. Ed. 663; Hilton *v.* Merritt, 110 U. S. 97, 3 S. Ct. 548, 28 L. Ed. 83; People *v.* State Board of Tax Com'rs, 196 N. Y. 39, 89 N. E. 581.

Motion overruled.

APPENDIX "C".

Court Rules.

1. *Rule 4 of the Supreme Court of Texas:*

When the application shall have been filed for a period of ten days, if the court shall determine to refuse the same, then whether the defendant has answered or not, the clerk of the court will retain the application, together with the transcript and accompanying papers, for fifteen days from the day of rendition of the judgment refusing the writ. At the end of that time, if no motion for rehearing has been filed, or upon the overruling or dismissal of such motion, in case one has been filed, the clerk of this court shall transmit to the Court of Civil Appeals to which the writ of error is sought a certified copy of the orders of this court denying such application and of the order overruling the motion for a rehearing thereof, and shall return the papers which belong to that court to the clerk thereof, but shall retain the petition for writ of error.

A motion for rehearing of an application for writ of error is not a matter of right, but in case such motion shall be filed within fifteen days after the refusal of the application and before the court shall adjourn for the term, the court will consider the same if it be based upon a ground not embraced in the application or contains the citation of authorities not before cited. The presentation of any point

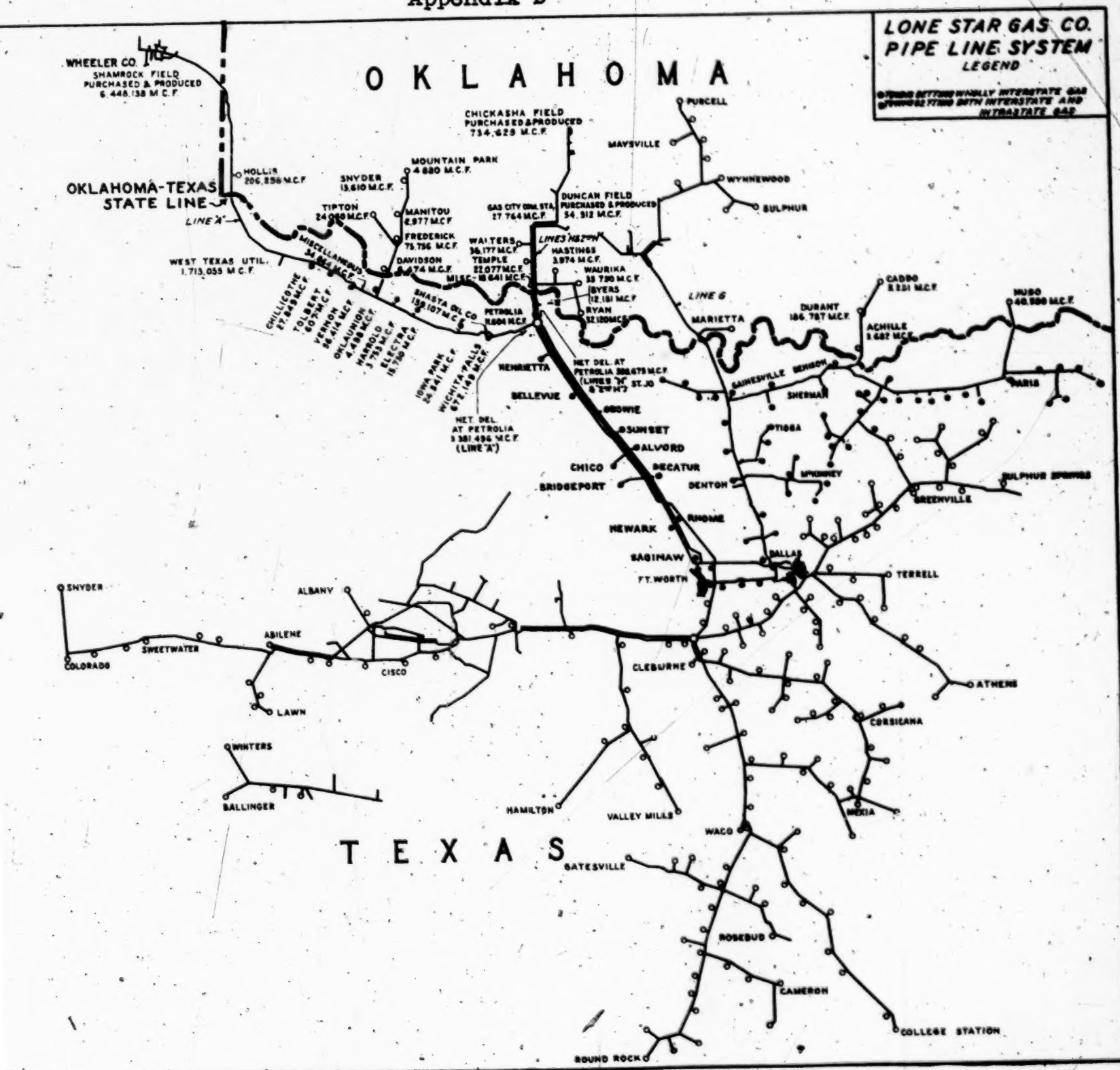
or points presented in the application without urging some new argument or citing some new authority will be deemed a sufficient ground for dismissing the motion.

2. *Rule 66, Texas Courts of Civil Appeals:*

Upon the presentation to him of an application for a writ of error, the clerk of the Court of Civil Appeals shall withhold the mandate until properly advised of the disposition of the case by the Supreme Court.

(Here follows one map, Appendix D, side folio 109.)

Appendix D


LONE STAR GAS CO.
PIPE LINE SYSTEM
LEGEND
OKLAHOMA
TEXAS
WHEELER CO.
SHAMROCK FIELD
PURCHASED & PRODUCED
6,448,138 M.C.F.
OKLAHOMA-TEXAS
STATE LINE
LINE 'A'
HOLLIS
206,256 M.C.F.
SNYDER
13,610 M.C.F.
MOUNTAIN PARK
4,880 M.C.F.
TIPTON
24,089 M.C.F.
MANITOU
2,977 M.C.F.
FREDERICK
75,756 M.C.F.
DAVIDSON
2,674 M.C.F.
MISCELLANEOUS
34,864 M.C.F.
WEST TEXAS UTIL.
1,713,055 M.C.F.
CHILLICOTHE
27,849 M.C.F.
TOLBERT
607 M.C.F.
VERNON
86,414 M.C.F.
OKLAUNION
4,838 M.C.F.
HARROLD
3,793 M.C.F.
ELECTRA
15,790 M.C.F.
IOWA PARK
24,841 M.C.F.
WICHITA FALLS
672,148 M.C.F.
BHASTA OIL CO.
158,107 M.C.F.
PETROLIA
11,804 M.C.F.
NET DEL. AT PETROLIA
1,381,496 M.C.F.
(LINE 'A')
CHICKASHA FIELD
PURCHASED & PRODUCED
734,629 M.C.F.
GAS CITY GAS STA.
27,764 M.C.F.
DUNCAN FIELD
PURCHASED & PRODUCED
54,312 M.C.F.
WALTERS
36,177 M.C.F.
TEMPLE
22,077 M.C.F.
MISC. 18,641 M.C.F.
HASTINGS
3,974 M.C.F.
WAURIKA
35,790 M.C.F.
BYERS
12,181 M.C.F.
RYAN
32,120 M.C.F.
LINE 'G'
LINE 'G'
NET DEL. AT PETROLIA 388,675 M.C.F.
(LINES 'H' & 'J')
PURCELL
MAYSVILLE
WYNNEWOOD
BULPHUR
MARIETTA
DURANT
186,787 M.C.F.
CADDO
8,231 M.C.F.
ACHILLE
3,682 M.C.F.
HUGO
48,598 M.C.F.
PARIS
SHERMAN
DENISON
GAINESVILLE
HENRIETTA
BELLEVUE
GOODNIE
SUNSET
ALVORD
CHICO
DECATUR
BRIDGEPORT
DENTON
PTTOGA
LEWISVILLE
GREENVILLE
SULPHUR SPRINGS
NEWARK
RHOME
SAGINAW
FT. WORTH
DALLAS
TERRELL
SNYDER
COLORADO
SWEETWATER
ABILENE
ALBANY
CISCO
LAWN
CLEBURNE
ATHENS
CORSICANA
WINTERS
BALLINGER
HAMILTON
VALLEY MILLS
WACO
MEXIA
GATESVILLE
ROSEBUD
CAMERON
COLLEGE STATION
ROUND ROCK